

LIST

OF

FILES

JOINT LEGISLATIVE HIGHER EDUCATION SCHOLARSHIP FUNDING TASK
FORCE, 2009-2010 (SCOMM 166)

MEMBERS:

SENATOR KEVIN MEYER, CHAIR
REPRESENTATIVE PAUL SEATON, VICE-CHAIR
REPRESENTATIVE ANNA FAIRCLOUGH
REPRESENTATIVE WES KELLER
REPRESENTATIVE PEGGY WILSON
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SENATOR JOHNNY ELLIS
SENATOR LYMAN HOFFMAN
SENATOR GARY STEVENS
SENATOR JOE THOMAS
SENATOR LINDA MENARD, ALTERNATE

Established by Sec. 10, Ch. 14 SLA 2010 (SB 221)

The Joint Legislative Higher Education Scholarship Funding Task
Force Report to the Legislature, Fall 2010, is currently online at
[http://hesf.aksenate.org/wp-
content/uploads/2010/12/2010_Scholarship_Funding_Final_Report.pdf](http://hesf.aksenate.org/wp-content/uploads/2010/12/2010_Scholarship_Funding_Final_Report.pdf)

LIST OF FILES (PAGE 1)

Report to the Legislature, Fall 2010

Proposed Legislation and Meeting Materials

Proposed Legislation and Meeting Materials

<TARGET><BILL></BILL><SUBJECT>Proposed Legislation and
Meeting Materials</SUBJECT><COMM>JESF26</COMM></TARGET>

**JOINT LEGISLATIVE
HIGHER EDUCATION SCHOLARSHIP FUNDING
TASK FORCE**

Meeting II AGENDA

Friday, September 17, 2010

8:30 -11:30am

Anchorage LIO, 2th Floor Senate Conference Room, Room 220

Subject: Merit-Based Component

Chair Opening Remarks

Old Business

- Answers to Member Question

New Business: Merit Scholarship

- Review of Statutory Framework
- Review of Refined Estimate of Awardee (Student) Pool
- Review of Refined Estimate of Programmatic Cost

Member Discussion

Closing Remarks & Adjournment

Sec. 14.03.113. District determination of scholarship eligibility.

A school district shall determine whether a student who graduates from a high school in the district is eligible for an award of an Alaska merit scholarship program scholarship under AS 14.43.810 - 14.43.850. If a student is eligible, the district shall state in the student's permanent record the highest level of funding for which the student is eligible. A district shall provide a student with an opportunity to request that the district correct an error in the eligibility determination.

Sec. 14.43.810. Alaska merit scholarship program established; regulations.

- a) The Alaska merit scholarship program is established to provide scholarships for high school graduates who are Alaska residents to attend a qualified postsecondary institution in the state.
- b) The department shall, in consultation with the commission, adopt regulations necessary to implement the program. The commission shall administer the daily operations of the program and financing of the program, including the procedures for applying for the scholarships, establishing standards for and ensuring continuing compliance with programmatic standards, and requiring students to apply for other non loan financial aid, consistent with federal law.

Sec. 14.43.820. Alaska merit scholarship program; eligibility.

- a) Subject to appropriation, the commission shall award an Alaska merit scholarship program scholarship to an applicant who
 - (1) is a resident of the state as defined in AS 01.10.055;
 - (2) graduated or will graduate within six months from a high school in the state;
 - (3) has completed a core academic curriculum in high school that includes
 - (A) four years of mathematics, four years of language arts, four years of science, and four years of social studies, one year of which may include a foreign language, an Alaska Native language, fine arts, or cultural heritage; or
 - (B) three years of mathematics, four years of language arts, three years of science, four years of social studies, and two years of a foreign language or an Alaska Native language;
 - (4) has a minimum grade-point average in high school of 2.5 or higher; the department shall set by regulation minimum requirements based on a substantially similar standard for districts that do not assign grades;
 - (5) has achieved a minimum score on a
 - (A) college entrance examination; or

- (B) standardized examination designed to measure a student's level of preparedness to make the transition to work, as selected by the department; and
 - (6) is enrolled in good standing in a course of study at a qualified postsecondary institution in this state that is intended to result in the award of a certificate or degree.
- b) The commission shall establish in regulation standards for continuing and regaining eligibility for a scholarship.

Sec. 14.43.825. Maximum annual awards.

- a) The maximum annual awards for the Alaska merit scholarship program scholarships are as follows:
- (1) the first award level is \$4,755 and requires a 3.5 grade-point average or above and a very high minimum score on a college entrance examination;
 - (2) the second award level is \$3,566 and requires a 3.0 grade-point average or above and a high minimum score on a college entrance examination;
 - (3) the third award level is \$2,378 and requires a 2.5 grade-point average or above and a moderately high minimum score on a college entrance examination.
- b) A student's eligibility for a scholarship terminates six years after the date the student graduated from high school unless the student qualifies for an extension of time allowed by the department by regulation.
- c) Except as provided in (b) of this section, a student receiving a scholarship may remain eligible for up to eight semesters of enrollment in good standing at a qualified university or college, which may include graduate courses.
- d) Scholarships may be awarded to a full-time student or, if a student is enrolled part time, prorated based on the number of credits. In this subsection, "full time" means enrollment in a course of study that is not less than 12 credits, and "part time" means enrollment in a course of study that is not less than six credits but less than 12 credits.
- e) The amount of a scholarship award may not exceed the amount of the student's costs of attendance as certified by the postsecondary institution for the purposes of federal financial aid, less any other scholarships or non loan financial aid awarded to the student.
- f) Payment of a scholarship is subject to appropriation. If insufficient funds are appropriated to pay all eligible scholarships, the commission shall pay existing awards on a pro rata basis.

Sec. 14.43.830. Qualified postsecondary institutions.

- (a) The following institutions are qualified postsecondary institutions for purposes of awarding an Alaska merit scholarship program scholarship:
 - (1) a university or college physically located in the state that is
 - (A) authorized to operate in the state under AS 14.48.020 or is exempt from authorization under AS 14.48.030(b)(1); and
 - (B) accredited by a regional accreditation association;
 - (2) a career and technical school program physically located in the state that has been included on a list of certified career and technical school programs received from the Department of Labor and Workforce Development; the commission shall publish the list on or before June 30 of the year preceding enrollment.
- (b) The Department of Labor and Workforce Development shall, in consultation with the Department of Education and Early Development, adopt regulations under AS 44.62 (Administrative Procedure Act) establishing criteria under which the Department of Labor and Workforce Development shall certify career and technical school programs in the state as eligible to participate in the Alaska merit scholarship program.

Sec. 14.43.840. Report to the legislature.

- (a) To the extent permitted under law, the department, the commission, the University of Alaska, and the Department of Labor and Workforce Development shall share data necessary to prepare public reports regarding the program.
- (b) Not more than 10 days after the convening of each regular legislative session, the department, the commission, the University of Alaska, and the Department of Labor and Workforce Development shall present an annual report to the public, the governor, and the legislature containing information of public interest regarding the program, including
 - (1) the number of applicants and number and types of scholarships awarded;
 - (2) the dollar amount of scholarships awarded in past years and the dollar amount expected to be awarded for the next year; and
 - (3) data and trends in the data regarding high school and postsecondary student performance, programmatic changes, and retention and graduation rates over time.

Sec. 14.43.850. Definitions.

In AS 14.43.810 - 14.43.850, unless the context requires otherwise,

- (1) "department" means the Department of Education and Early Development;
- (2) "grade-point average" means the average of all grades on a four²⁹ point scale, or five-point scale for advanced placement classes, obtained by the student in high school;
- (3) "high school" means a public or accredited secondary school in the state and a home school program that is approved by the department;
- (4) "program" means the Alaska merit scholarship program established under AS 14.43.810 - 14.43.850;
- (5) "school district" means a borough school district, a city school district, a regional educational attendance area, and a state boarding school.

TRANSITION: PROGRAM STANDARDS AND IMPLEMENTATION FOR INITIAL SCHOOL YEARS.

Notwithstanding any contrary provision of this Act, the Department of Education and Early Development and the Department of Labor and Workforce Development, after consultation with the Alaska Commission on Postsecondary Education, may adopt regulations under AS 44.62 (Administrative Procedure Act) to implement their respective duties under the Alaska merit scholarship program established in AS 14.43.810, enacted by sec. 5 of this Act, so that a student

- (1) may be eligible for the program even though the student did not fully meet the required core academic curriculum for the school years beginning July 1, 2010, through June 30, 2014; and
- (2) who graduated from high school in this state after January 1, 2011, and before July 1, 2011, and meets eligibility requirements for the program may apply for a scholarship on or after January 1, 2011, for enrollment in a program of study beginning on or after July 1, 2011.

TRANSITION: REGULATIONS.

The Department of Education and Early Development, the Department of Labor and Workforce Development, and the Alaska Commission on Postsecondary Education may proceed to adopt regulations necessary to implement changes made to their respective authorities by secs. 1, 2, 5, 7, and 8 of this Act. The regulations take effect under AS 44.62 (Administrative Procedure Act), but not before July 1, 2011, except that regulations pertaining to applications for scholarships may take effect on or after January 1, 2011.

Representative Wilson -

Report on remedial education. Who takes remedial courses at UA? In particular what percentage of incoming freshman takes remedial courses? How much does it cost to offer remedial education?

National data from the U.S. Department of Education on participation in remedial education found that 34% of all new entering college students required at least one remedial education class. Of those students who enrolled in a community college, 43% required some remedial education. While these numbers are alarming, more recent research on participation rates at the state level paint an even bleaker picture. Recent state analyses conducted by ECS reveal that many states have remediation participation rates between 30% and 40%, with some states having rates over 50%.

Bruce Vandal
“Getting Past Go”
Education Commission of the States (ECS)

University of Alaska First-Time Freshmen Taking Preparatory Coursework by Recent and Other First-Time Freshmen Designation, Fall 2009

	All FTF	%	Recent FTF	%	Other FTF	%
Total Headcount Fall 2009	3588		2355		1233	
Took Preparatory Course work:						
Eng & Math	689	19.2	511	21.6	178	14.4
Eng OR Math	1929	53.7	1369	58.1	560	45.4
Any Subject	1946	54.2	1383	58.7	563	45.6
Math	1632	45.4	1163	49.3	469	38
English	986	27.4	717	30.4	269	21.8
Science	23	<1	19	<1	4	<1
Dev Studies	77	2.1	63	2.6	14	1

University of Alaska UA Scholar First-Time Freshmen Taking Preparatory Coursework, Fall 2009

Total Headcount, Fall 2009	444	
Took Preparatory Course work:		%
English AND Math	50	11.2
English OR Math	149	33.5
Any Subject	154	34.6
Math	121	27.5
English	78	17.5
Science	3	<1
Developmental Studies	21	4.7

*Note- For this Analysis First-Time Freshmen are considered Recent if they are under 20 as of Sept 1, 2009
Compiled by Statewide Planning and Institutional Research*

Student Credit Hours by Course Level – UA System, Fall 2009

<u>Preparatory</u>	<u>Lower Division</u>	<u>Upper Division</u>	<u>Professional</u>	<u>Graduate</u>	<u>Total</u>
10,810	190,549	49,025	5,299	17,467	273,150

For fall 2009 UA delivered 10,810 student credit hours in preparatory coursework. This is equal to 4% of the total credit hours for that term (273,150).

Senator Stevens -

Report on academic advising from the MAU's. Who receives advising? How are advisors assigned? Is academic advising mandatory? [This question was spurred by Sen. Stevens recalling testimony by a UAA student – a senior who claimed he had not received any academic advising his entire UAA career.]

UA Southeast: Yes and no. Students who are placed on probation, continued on probation, receive an academic warning which requires mandatory advising prior to registering for future semesters. Other students are highly encouraged to meet with an advisor but it is not mandatory.

Students are assigned based upon their degree program. If they are not in a degree program they are welcome to visit the student resource center

Our advisors consist of both professional and faculty advisors. The advisors from all academic areas (including Sitka and Ketchikan) meet monthly during the academic year for an advising meeting. A retreat has been implemented 4 years ago for the summer months where everyone meets face to face. An advising handbook has been developed and is posted online. The target audience is faculty and staff advisors. The group is working on an advising syllabus intended for students.

UA Fairbanks: Academic advising is mandatory for all undergraduate degree-seeking students. Students are assigned to advisors based on their major. Department chairs choose how students are assigned to advisors within their department. When admitted to UAF, students are given contact information concerning their academic advisor's department with their acceptance letter. Undergraduate baccalaureate students who chose "Undeclared Bachelor's" on their UAF application are assigned advisors from the Academic Advising Center.

Degree-seeking students are not allowed to register for the upcoming semester until they have met with their advisor and the advisor has signed their registration form. Academic advisor signatures are also required for semester credit overload approvals; academic petitions; to audit, add or drop/withdraw from courses after the last day of late registration; late withdrawal or audit after the last day to withdraw; and for a late total withdrawal after the last day to withdraw.

Non-degree seeking students are not assigned an academic advisor. However, they are encouraged to meet with one, especially if they have been academically disqualified, are taking nine or more credits in a semester, or have accumulated 30 or more UAF credits. These students can receive advising from the Academic Advising Center or the academic department that is most closely aligned with their interests.

Additionally, some students may receive advising through specific programs such as Rural Student Services, Student Support Services, Honors Program, Office of International Programs, and Northern Military Programs.

UA Anchorage: Academic Advising is not mandatory at UAA. At the point of admission students are instructed which department to contact for advisement. Each department assigns advisers

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differently, some alphabetically, some by cohort, etc. There are as many different ways of assigning as there are departments to assign.

We feel we have had huge success with the implementation of degree works. This tool has allowed greater clarification of requirement, allowed for simplified distance advisement and pushed student to meet with their advisers sooner in the program cycle so that we are dealing with concerns two or three semesters before graduation allowing for student adjustments rather than two weeks after commencement when the student “thought” they graduated.

Representative Fairclough -

1. Report on the employee tuition waiver benefit. How many credits are utilized through this program? A breakdown of who uses this benefit and costs of the program. Registration processes for this benefit do employees or dependent wait until all other 'paying students' are registered before they register?

[The data requested to address this question was not available in time for the task force meeting. I will present the data at our next meeting.]

Registration processes at all MAU's: students who utilize the Employee Benefit are not treated any differently – they are eligible to register according to their student status (i.e. freshman, sophomore, graduate, non-degree seeking, etc.)

Employee tuition waivers pay only for tuition. Tuition waiver forms must be turned in by the fee payment deadline. The employee is responsible for all other fees. The employee must be employed on the first day of instruction to be eligible. Employees who pay for a course and later become eligible for a waiver will not be reimbursed. Late fees and payment deadlines apply to those using tuition waivers.

2. Report on housing revenue versus costs at the MAU's – do revenues exceeds the cost of housing? [This request was prefaced by the statement that she - Rep. Fairclough as does Sen. Meyer - has children attending college].

UA Southeast: Due to aging facilities and increasing cost of maintenance and repair, the costs of owning and operating student housing generally exceeds receipts on an annual basis, and requires support from other revenue sources.

UA Fairbanks: All housing revenue at UAF is used for housing-related expenses. Revenue is generated from fees, rents and guest operations. On a yearly basis any revenue earned that is in excess to expenses is placed in an account to be used as both an emergency fund and to perform housing-related maintenance. No funds generated from housing operations are used for non-housing related purposes.

UA Anchorage: Revenues do not exceed costs, and in the case of UAA, the dining program supplements our revenue in order to balance the cost of housing. Housing on its own typically ends in the red. As a combined budget, if projected revenues do not come in and costs exceed our projections, we still run the risk of being in the red at year end.

What impacts our budget the hardest is the \$1.7M that we pay in debt service for the halls and commons buildings. In addition, increases to payroll/benefits, increases in M&R costs as the buildings age and increases to utilities can push up our costs. To balance this, we work to bring in additional revenues through increased sales in dining and conferencing. We generally need to raise student fees every year, but try to alternate housing and dining fee increases. Cost reductions are also part of our daily language around here as we look for ways to reduce our costs or get 'deals' on

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things such as our latest opportunity to receive furniture from the Student Union that otherwise would have gone to surplus.

UAA (only)

FY10 Student Housing Revenue was:	\$4,659,509
FY10 Student Housing Expenses were:	4,958,649
FY10 net:	(299,140)
FY10 revenue for UAA Housing, catering, dining and conferencing was:	\$8,747,495
FY10 costs were:	8,739,673
FY10 net:	<u>\$7,822</u>

Representative Seaton:

Report on students working on campus. How many students work on campus? What is the annual payroll for such students? What is the effect of work while enrolled on student success?

In fall 2009 UA had 1,428 student employees; 673 at UAA; 608 at UAF; 123 at UAS and 25 at SW.

Student employees at UA between Fall 2005-2009

<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>% Change 2005-09</u>
1,403	1,297	1,385	1,411	1,428	1.8

The following are excerpts from selected research on the relationship between persistence, retention and graduation and working while enrolled.

“While the federal government has had a strong college work-study program since the inception of the Higher Education Act in 1965, only 14 states have developed such programs. And only five of them – in Colorado, Minnesota, New Mexico, Pennsylvania, and Washington – are very substantial. From a student’s perspective, college work-study is hardly financial assistance. It generally involves hard work, often in less than ideal circumstances, for modest wages. Yet research on the federal program demonstrates that college work-study can contribute substantially to student success. Given that more than three-quarters of all students are employed, the question isn’t whether they should work or not but what kind of work best supports their needs. **Research by the American Council on Education shows that student in work-study jobs, who work 15 hours or less per week, are much more likely to succeed in completing their education than students who work in other jobs, particularly off campus jobs.”(1)**

David Longanecker, Nov. 2008 Getting What You Pay For (page 4)

His full report is here:

http://www.wiche.edu/files/gwypf/dal_finaid.pdf

- About three-quarters of all four-year college students now earn a paycheck, and about one-quarter of them work full time.
- Students can increase their likelihood of succeeding in college by enrolling in a rigorous high school program and limiting the number of hours they work while in college.
- Risk factors that make it more difficult for students to complete college include working full time, starting at a community college, and having parents who did not attend college.

Saichi Obi
150
x

(1) Susan P. Choy, *Access and Persistence: Findings from 10 Years of Longitudinal Research on Students* (Washington, DC: American Council on Education, 2002).

Her full report is here:

http://www.acenet.edu/bookstore/pdf/2002_access&persistence.pdf

Combining School and Work (2 articles)

1) Provide Opportunities for Work Study. Work-study positions are excellent opportunities for foster care alumni to earn money and work in areas that encourage study and learning. **Providing opportunities to work on campus will help foster care alumni obtain additional funding to finance their way through college while also allowing the students to get connected with campus resources and institutional personnel.** These opportunities will help foster care alumni adjust to the college environment and persist toward degree completion.

<http://www.nasfaa.org/subhomes/researchhome/nasfaafostercare%20report.pdf> (p 42)]

2) Students always have worked, whether full or part time, to help cover their educational expenses, but many in higher education may not recognize how many students are working while going to school or how much they are working. **Devoting any more than about 15 hours per week to paid work tends to affect academic performance negatively and imposes limitations on students, such as restricting their choice of classes, limiting the number of classes they can take or when they can take them, and reducing library access (Horn and Berkold 1998).** Such limitations may lessen students' desire to stay in school or slow their progress toward a degree.

Students can influence their likelihood of college success beginning in high school. All students can be encouraged to adopt behaviors associated with higher persistence, such as enrolling in a rigorous high school program and studying hard. They can also be encouraged to limit the number of hours worked while attending college.

Analysts measured the independent effects of work, borrowing, and attendance on persistence, controlling for other variables (including grades) likely to affect persistence. **Both attending part time and working more than 15 hours per week reduced the likelihood of persisting, while working one to 15 hours per week increased the likelihood of persisting.** Researchers also found that borrowing increased students' likelihood of persisting, perhaps by reducing their need to work and allowing them to attend full time at higher rates. This would give them more time to devote to their studies.

**Vincent Tinto (July 2004) Student Retention and Graduation:
Facing the truth, living with the consequences.**

Endowment Structure

Example A: **\$400 Million “Constitutional” Fund**

Equivalent: Permanent Fund

Operation:

- \$400 deposited to Capitalize Constitutionally-Created Fund
- Invested for Long-Term Return
- Earnings (\$20 M/yr at assumed 5% ROI) accrue to Account
- Excess Earnings Inflation-Proof Fund
- Account pays Scholarships

STRENGTH	WEAKNESS
<ul style="list-style-type: none"> • Highest potential for Long-term programmatic Sustainability • Principal is “Safe” • “Inflation proof” • Earnings provide Predictable Pay-out Funding Stream • Earnings: Very “Safe” from raiding if Const. protected 	<ul style="list-style-type: none"> • Necessity for Large Initial Investment • Necessity for Constitutional Amendment • Account is “Rare” • Higher “administrative” cost? • Subject to Market Volatility • Questionable Base for Programmatic Evolution
OPPORTUNITIES	THREATS
<ul style="list-style-type: none"> • High Profile Focal Point for “State Investment” • Highest likelihood of attracting outside donations 	<ul style="list-style-type: none"> • “Pandora’s Box” and the “Christmas Tree” Effect • Earnings susceptible to “raiding” if not Const. protected • Subject to Market Volatility

Endowment Structure

Example B: **\$400 Million General Fund Fund (Subaccount)**

Equivalent: Power Cost Equalization Fund

Operation:

- \$400 deposited to Capitalize Fund
- Invested for Long-Term Return
- Earnings (\$20 M/yr at assumed 5% ROI) accrue to Account
- Excess Earnings Inflation-Proof Fund
- Account pays Scholarships

STRENGTH	WEAKNESS
<ul style="list-style-type: none"> • High potential for Long-term programmatic Sustainability • “Tried” mechanism • Principal offers Strongest programmatic “insurance policy” of unprotected Fund-types • Earnings provide Predictable Pay-out Funding Stream 	<ul style="list-style-type: none"> • Necessity for Large Initial Investment • Higher “administrative” cost • Subject to Market Volatility • Questionable Base for Programmatic Evolution
OPPORTUNITIES	THREATS
<ul style="list-style-type: none"> • High Profile Focal Point for “State Investment” • Strong Base for programmatic Evolution • Likelihood of attracting outside donations 	<ul style="list-style-type: none"> • Principal susceptible to “raiding” • Earnings susceptible to “raiding”

“Rolling Fund” Structure

Example A: **Seaton Plans**

Equivalent: Community Revenue Sharing

Operation:

- Progressive Fund Capitalized up to \$160 Million
- Interest Bearing Fund
- Principal and Interest Earnings pay for Scholarships
- Yearly Appropriations used to Maintain Value of Fund Corpus

STRENGTH	WEAKNESS
<ul style="list-style-type: none"> • Low Capitalization Hurdle • “Tried” mechanism • Lower “administrative” cost than Endowment • Greater Pay-out Stream Predictability than Default • Principal acts as fixed-term programmatic “insurance policy” 	<ul style="list-style-type: none"> • Susceptible to Budget Volatility • Susceptible to “Budgetary Process” • Less than Predictable Pay-out Funding Stream • Low Likelihood of attracting outside donations
OPPORTUNITIES	THREATS
<ul style="list-style-type: none"> • Responsive to Programmatic Evolution • Some likelihood of attracting outside donations 	<ul style="list-style-type: none"> • Declining Oil Production/Revenue • Declining Federal Spending • Increasing Demand for Services • Principal susceptible to “raiding” • Earnings susceptible to “raiding”

“Rolling Fund” Structure

Example B: **Meyer Plan**

Equivalent: Community Revenue Sharing

Operation:

- Immediate Fund Capitalized up to \$200 Million
- Interest Bearing Fund
- Principal and Interest Earnings pay for Scholarships
- Yearly Appropriations* used to Maintain Value of Fund Corpus
 - *Dividends, program receipts and other funds (AIDEA, AK Housing, ACPE) regularly “directed” to Scholarship Fund

STRENGTH	WEAKNESS
<ul style="list-style-type: none"> • Moderate Capitalization Hurdle • “Tried” mechanism • Identified Fund Replenishment Stream • Lower “administrative” cost than Endowment • Greater Pay-out Stream Predictability than Default • Principal acts as fixed-term programmatic “insurance policy” 	<ul style="list-style-type: none"> • Necessity for Substantial Initial Investment • Susceptible to Budget Volatility • Susceptible to “Budgetary Process” • Less than Predictable Pay-out Funding Stream • Low Likelihood of attracting outside donations
OPPORTUNITIES	THREATS
<ul style="list-style-type: none"> • Responsive to Programmatic Evolution • Some likelihood of attracting outside donations 	<ul style="list-style-type: none"> • Declining Oil Production/Revenue • Declining Federal Spending • Increasing Demand for Services • Principal susceptible to “raiding” • Earnings susceptible to “raiding”

Default Structure

Example: **Pay-As-You-Go**

Equivalent: Senate Bill 221

Operation: Yearly Appropriation to Support Programmatic Costs

STRENGTH	WEAKNESS
<ul style="list-style-type: none"> • Most Routine funding mechanism • No need for “account” creation • Lowest “administrative” cost • Yearly funding most directly matches yearly programmatic cost • Leaves greatest level of budgetary flexibility 	<ul style="list-style-type: none"> • Most susceptible to Budget Volatility • Most susceptible to “Budgetary Process” • Least Predictable Pay-out Funding Stream • Low Likelihood of attracting outside donations
OPPORTUNITIES	THREATS
<ul style="list-style-type: none"> • Most responsive to Programmatic Evolution 	<ul style="list-style-type: none"> • Declining Oil Production/Revenue • Declining Federal Spending • Increasing Demand for Services

State Fiscal “101”

Revenue and Appropriations

Joint Legislative Higher Education
Scholarship Funding Task Force

Outline

- Where does the state get its revenue?
- How is the revenue accounted?
- How is the revenue expended?

Revenue Sources

- Oil
- Non-Oil (excluding Investment)
- Investment
- Federal

Oil Revenue

- Royalty
 - Leasing of state land and royalty payment as land owner
- Production Tax
 - Net profits tax on production
- Petroleum Property Tax
 - Property tax on oil and gas property in state
- O&G Corporate Income Tax
 - Income tax on oil and gas corporations

Non-Oil (excluding investment)

- Corporate Income Tax (non-oil companies)
- Excise Taxes
 - Tobacco, alcoholic beverages, motor fuel
- Licenses and Permits
 - Fishing Hunting, Motor Vehicle
- Charges for Services
 - Marine Highway, other program receipts

Investment Income

- GF Earnings (relatively new)

- CBR ~~33.2 billion~~ / FY11 ~~\$35.7 bil~~
FY10 \$8.7 bil subaccount = ??

- Permanent Fund \$32 b

Fed Rev. \$3. Bill. FY10

How is revenue accounted?

- The primary operating fund of the state is the General Fund
 - The general fund has numerous sub-funds created by law *90 sub funds*
- Other fund types outside the general fund include (but not limited to):
 - Permanent Funds
 - Fiduciary Funds *PERS / TERS*
 - Component Units

Accounting ≠ Budgeting

Both accounting and budgeting are fiscal systems

- Accounting focuses on recording financial transactions
- Budgeting is more the enactment of a fiscal plan
 - Budget processes are dependent upon the accounting of past and current year expenditures and revenue
- Accounting follows generally accepted accounting practices (GASB)
- Budgeting does not follow a stringent set of rules

How is revenue expended?

- Legislature has the **Power of Appropriation**
 - No expenditure of state funds w/o an appropriation
- Legislature appropriates funds based on levels of discretion

Levels of Discretion (Highest to Lowest)

Fund sources (revenues) grouped according to levels of discretion

- Unrestricted General Funds
- Designated General Funds
- Other State Funds
- Dedicated Funds

Dedicated

- Very little discretion how appropriated
- Article IX, Section 7 of the Constitution prohibits the dedication of revenue to any special purpose
 - Exceptions:
 - Article IX, Section 15 – Permanent Fund
 - Dedication prior to Statehood
 - Federal

Other State Funds

- Little discretion how appropriated
- Although not dedicated, funding sources in the group typically are restricted in some fashion
 - Contractual obligation
 - Bonds
 - Held in trust
 - PERS, TRS, etc.
 - Court order
 - Mental Health Trust
 - Legal separation
 - Corporate receipts

Designated General Funds

- Designated General funds consist of fund sources that have been “designated” for a special purpose in statute
- Constitutional prohibition “trumps” statutory designation
- Therefore, Legislature has complete discretion on use of funding
- However, Legislature typically follows statutory “guidelines”

Unrestricted General Funds

- Complete discretion how appropriated
- Typically referenced as a measure of state spending
- Utilized when calculating the Fiscal Surplus or Fiscal Gap
 - General Fund Revenue less General Fund Appropriations = Fiscal Surplus or (Gap)
- Approximately 90% of GF revenue is derived from Oil

The Question?

- The levels of discretion play a large role in budgeting and financing programs
- What level is best?
- Example's:
 - PCE – statutory endowment
 - Revenue Sharing – rolling type plan
 - Pay as you go – most state programs

Questions?

From: Louie Flora
Sent: Tuesday, October 05, 2010 10:20 AM
To: Jomo Stewart; Sen. Kevin Meyer
Subject: Draft legislation scholarship funding mechanisms
Attachments: Scholarship funding draft Alaska Scholarship fund.pdf; Scholarship funding draft AlaskaAdvantage.pdf

Hi Jomo,

Attached please find two pieces of draft legislation that Representative Seaton has discussed with Senator Meyer for inclusion in the Scholarship Task Force deliberations.

The first draft legislation (version M) would create a scholarship fund that operates like the Community Revenue Sharing fund. One third of the fund would be automatically distributed to scholarship recipients annually. If the Legislature wants to see the program continue, they would annually replenish the fund with an appropriation equal to the distribution. The fund would remain viable to pay the full obligation if the Legislature did not make an appropriation for one year. If the fund is not replenished for two years by any source and the balance falls below a benchmark level, the administrator could stop making any new commitments to scholarship recipients while still maintaining the obligation to students who have already been awarded a scholarship. This version does not propose a Needs-based structure, but provides a reliable mechanism that may be used to fund a Need-based component as well as the existing Merit Scholarship.

The second piece of draft legislation (version B) establishes a Need-based component through the existing AlaskaAdvantage need-based grant program. The funding mechanism in this version is identical to the scholarship fund in Version M discussed above, but would provide for Need-based AlaskaAdvantage grants as well as merit scholarships.

Please distribute to Scholarship Task Force members.

Louie Flora
Staff, Representative Seaton
(907) 235-2921

27-LS0078\M
Mischel
9/7/10

HOUSE BILL NO.

IN THE LEGISLATURE OF THE STATE OF ALASKA
TWENTY-SEVENTH LEGISLATURE - FIRST SESSION

BY

Introduced:

Referred:

A BILL

FOR AN ACT ENTITLED

1 **"An Act relating to Alaska scholarship awards; and establishing the Alaska scholarship**
2 **award income account and the Alaska scholarship fund."**

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

4 *** Section 1.** AS 14.43.825(f) is repealed and reenacted to read:

5 (f) Payment of a scholarship is subject to appropriation and the availability of
6 funds for expenditure under AS 37.14.750. If insufficient funds are appropriated or
7 available in a fiscal year to pay all eligible scholarships, the commission may not
8 award a scholarship to a new applicant and the commission shall pay existing awards
9 on a pro rata basis for that fiscal year.

10 *** Sec. 2.** AS 14.43 is amended by adding a new section to read:

11 **Sec. 14.43.835. Alaska scholarship award income account.** The Alaska
12 scholarship award income account is created as an account in the general fund. Money
13 may be appropriated into the account from the Alaska scholarship fund under
14 AS 37.14.750 and from other sources. The commission may use the money in the

1 account to pay scholarships awarded to students under AS 14.43.810 - 14.43.849. The
2 amount determined under AS 37.14.750(c) each year and deposited into the account is
3 the maximum amount that may be used to pay scholarships for the immediately
4 succeeding fiscal year.

5 * **Sec. 3.** AS 37.14 is amended by adding a new section to read:

6 **Article 8A. Alaska Scholarship Fund.**

7 **Sec. 37.14.750. Alaska scholarship fund established.** (a) The Alaska
8 scholarship fund is established in the general fund for the purpose of making
9 scholarship payments to qualified postsecondary institutions and students under
10 AS 14.43.810 - 14.43.849. The fund consists of money appropriated to the fund.
11 Income earned on money in the fund and donations to the fund may be appropriated to
12 the Alaska scholarship income account established in AS 14.43.835. Money in the
13 fund does not lapse.

14 (b) Each fiscal year, the legislature may appropriate to the Alaska scholarship
15 fund an amount equal to 20 percent of the money received by the state during the
16 previous calendar year under AS 43.55.011(g). The amount may not exceed the
17 greater of

18 (1) \$40,000,000; or

19 (2) the amount that, when added to the fund balance on June 30 of the
20 previous fiscal year, equals \$160,000,000.

21 (c) The balance in the Alaska scholarship fund shall be determined on June 30
22 of each year. The department shall distribute one-third of that amount or \$40,000,000,
23 whichever is less, for deposit into the account established in AS 14.43.835. If the fund
24 balance is less than \$80,000,000 in a fiscal year, payments may be made only to
25 satisfy obligations from previous fiscal years.

26 (d) Notwithstanding the limitation in (b) of this section, the legislature may
27 appropriate any amount to the Alaska scholarship fund. Nothing in this section creates
28 a dedicated fund.

29 (e) In this section, unless the context requires otherwise, "fund" means the
30 Alaska scholarship fund established in (a) of this section.

31 * **Sec. 4.** The uncodified law of the State of Alaska is amended by adding a new section to

1 read:

2 TRANSITION: ALASKA SCHOLARSHIP FUND BALANCE. Notwithstanding the
3 \$40,000,000 limit in AS 37.14.750(b), the following amounts shall be substituted for that
4 amount as follows for

5 (1) fiscal year 2012, \$15,000,000;

6 (2) fiscal year 2013, \$30,000,000.

HOUSE BILL NO.

**IN THE LEGISLATURE OF THE STATE OF ALASKA
TWENTY-SEVENTH LEGISLATURE - FIRST SESSION**

BY

Introduced:

Referred:

A BILL

FOR AN ACT ENTITLED

1 **"An Act relating to AlaskAdvantage education grant funding and to Alaska scholarship**
2 **funding; and establishing an account and fund for those purposes."**

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

4 *** Section 1.** AS 14.43.410 is amended by adding a new subsection to read:

5 (c) Notwithstanding the provisions of this section, payment of a grant is
6 subject to appropriation and the availability of funds for expenditure under
7 AS 37.14.750. If insufficient funds are appropriated or available in a fiscal year to pay
8 all eligible grants, the commission may not award a grant to a new applicant, and the
9 commission shall pay existing awards on a pro rata basis for that fiscal year.

10 *** Sec. 2.** AS 14.43.825(f) is repealed and reenacted to read:

11 (f) Payment of a scholarship is subject to appropriation and the availability of
12 funds for expenditure under AS 37.14.750. If insufficient funds are appropriated or
13 available in a fiscal year to pay all eligible scholarships, the commission may not
14 award a scholarship to a new applicant, and the commission shall pay existing awards

1 on a pro rata basis for that fiscal year.

2 * **Sec. 3.** AS 14.43 is amended by adding a new section to read:

3 **Sec. 14.43.915. AlaskAdvantage education grant and Alaska scholarship**
4 **award income account.** The AlaskAdvantage education grant and Alaska scholarship
5 award income account is created as an account in the general fund. Money may be
6 appropriated into the account from the AlaskAdvantage education grant and Alaska
7 scholarship fund under AS 37.14.750 and from other sources. The commission may
8 use the money in the account to pay grants awarded under AS 14.43.400 - 14.43.420
9 and scholarships awarded to students under AS 14.43.810 - 14.43.849. The amount
10 determined under AS 37.14.750(c) each year and deposited into the account is the
11 maximum amount that may be used to pay scholarships for the immediately
12 succeeding fiscal year.

13 * **Sec. 4.** AS 37.14 is amended by adding a new section to read:

14 **Article 8A. AlaskAdvantage Education Grant and Alaska Scholarship Fund.**

15 **Sec. 37.14.750. AlaskAdvantage education grant and Alaska scholarship**
16 **fund established.** (a) The AlaskAdvantage education grant and Alaska scholarship
17 fund is established in the general fund for the purpose of making grant payments under
18 AS 14.43.400 - 14.43.420 and scholarship payments to qualified postsecondary
19 institutions and students under AS 14.43.810 - 14.43.849. The fund consists of money
20 appropriated to the fund. Income earned on money in the fund and donations to the
21 fund may be appropriated to the AlaskAdvantage education grant and Alaska
22 scholarship award income account established in AS 14.43.915. Money in the fund
23 does not lapse.

24 (b) Each fiscal year, the legislature may appropriate to the AlaskAdvantage
25 education grant and Alaska scholarship fund an amount equal to 20 percent of the
26 money received by the state during the previous calendar year under AS 43.55.011(g).
27 The amount may not exceed the greater of

28 (1) \$40,000,000; or

29 (2) the amount that, when added to the fund balance on June 30 of the
30 previous fiscal year, equals \$160,000,000.

31 (c) The balance in the AlaskAdvantage education grant and Alaska

1 scholarship fund shall be determined on June 30 of each year. The department shall
2 distribute one-third of that amount or \$40,000,000, whichever is less, for deposit into
3 the account established in AS 14.43.915. If the fund balance is less than \$80,000,000
4 in a fiscal year, payments may be made only to satisfy obligations from previous fiscal
5 years.

6 (d) Notwithstanding the limitation in (b) of this section, the legislature may
7 appropriate any amount to the AlaskAdvantage education grant and Alaska
8 scholarship fund. Nothing in this section creates a dedicated fund.

9 (e) In this section, unless the context requires otherwise, "fund" means the
10 AlaskAdvantage education grant and Alaska scholarship fund established in (a) of this
11 section.

12 * **Sec. 5.** The uncodified law of the State of Alaska is amended by adding a new section to
13 read:

14 **TRANSITION: ALASKADVANTAGE EDUCATION GRANT AND ALASKA**
15 **SCHOLARSHIP FUND BALANCE.** Notwithstanding the \$40,000,000 limit in
16 AS 37.14.750(b), the following amounts shall be substituted for that amount as follows for

17 (1) fiscal year 2012, \$15,000,000;

18 (2) fiscal year 2013, \$30,000,000.

State of Alaska

Commission on Postsecondary Education

Resolution 2010 - 03

WHEREAS, the Alaska Commission on Postsecondary Education has noted with concern the increasing costs of education for Alaska students and the financial jeopardy from those costs; and

WHEREAS, the percentage of Alaskans entering postsecondary education is among the lowest in the nation; and

WHEREAS, there is a growing drop-out rate and non-graduation rate in Alaska's secondary schools; and

WHEREAS, there is an increasing number of entering college students needing remediation in core subjects to progress through degree programs; and

WHEREAS, the Commission believes that the scholarship program will provide incentives to Alaska students to attain higher performance in secondary school, complete their high school diploma, and plan to attend postsecondary education; and

WHEREAS, the scholarships will also help lower the cost of education for students and leave them in better financial status as they complete degrees or certifications; and

NOW, THEREFORE, BE IT RESOLVED, the Alaska Commission on Postsecondary Education strongly urges the Legislative Task Force to propose to the Alaska Legislature the establishment of long-term funding for both merit-based and needs-based scholarships for financial aid at Alaska postsecondary institutions.

DATED: October 6, 2010

Dave Rees, Chair
Becky Huggins, Vice Chair
Milton Byrd
Jennifer Chambers
Fuller Cowell
Sharon Charnell Gherman

Hugh Grant
Pat Jacobson
Spike Jorgensen
Jim Merriner
Jan Sieberts
Lydia Wirkus

Rep. Seaton

Needs-Based Funding Recommendations:

1. Under SB 221 a need-based supplement to the merit scholarship was to be addressed through the AlaskaAdvantage program. That program has targeted non-traditional, older students. Seeking to make scholarship qualifications the same for non-traditional students as for traditional leads to confusing complexity. The rigorous curriculum required of the merit qualified traditional student does not easily apply to a student who has been out of high school for years and the high grade point average qualification is often not applicable for those students. ***The Taskforce should recommend separating need-based awards into two programs. The current AlaskaAdvantage would serve the non-traditional, General Education Development (GED), and older students as prioritized for grants under the program's current criteria. A need-based component should also be included in the merit scholarship in order to target traditional students.***

[Murray: I wonder if the inclusion of two need's based scholarship programs would be a problem, and I am not sure I see the need to have BOTH AlaskAdvantage and an academic need's based scholarship. I think the AA program could take care of both. Rep. Seaton is right when he says below that the pool of AA would be reduced by pool of merit scholars, but probably not by much. Statistically, as was shown in the last few presentations, many lower income students will NOT be in a position to earn the academic scholarship. However their need may be much greater. We can both reward good grades and enable lower income students by offering both.]

The pool of AlaskaAdvantage applicants would be reduced by the existence of the merit scholarship which targets traditional students via the need-based supplement. By providing financial assistance to non-traditional students who may already be on the road to degree completion, AlaskaAdvantage is a vital program if our goal is to increase the educated workforce and citizenry of the State. AlaskaAdvantage could be funded within the same mechanism as the merit scholarship and its need-based supplement but would target criteria and goals to increase non-traditional student graduation.

2. The goal of integrating a need-based component into the merit scholarship was to ensure that the lesser socio-economic advantaged students who qualify for the merit scholarship would have the economic ability to use their merit award. Obviously, if there is a large unmet need and no ability to finance those costs the tuition merit scholarship cannot provide educational opportunity. The need-based supplement is set

at 50% of annual University of Alaska (UA) cost, less \$2,000 for student work contribution. This uncapped system creates potential for indeterminate funding liability as UA costs increase over time. To eliminate the cost inflation liability ***the taskforce should recommend to cap the maximum need-based supplement at the 2010 amount of \$4,700 as we have similarly capped the merit award at the 2010 UA tuition amount.*** It would take action by a future legislature, when the facts are known, to adjust either amount.

[Murray: It would be easier (and possibly less expensive) to eliminate the academic needs-based scholarship in favor of one needs based program.]

Other Policy Recommendations for Our Scholarship Investments:

A goal of the Legislature in creating a merit scholarship program was to provide the transformation pressure for K-12 to adequately prepare students for entry into college and career/tech without needing developmental education (remedial) courses. We recognize that remedial courses cost money and do not count for degree credit. By delaying progress toward completion these courses quite substantially reduce the probability that the student will ever complete the degree/certificate.

Since our investment objective is degree/certificate completion – not simply attendance – we should look at other factors that produce delay in progress and therefore contribute significantly to non-completion. What other policies should we institute in the scholarship program to stimulate postsecondary education changes to incentivize completion and make our money count? On-time completion will also become vital to Alaska institutions as a scholarship program becomes fully implemented because the anticipated growth in student enrollment will overwhelm available capacity if students do not progress more rapidly. The following three suggestions are for programmatic recommendations to advance that goal.

- 1. The taskforce should recommend that any institution which accepts scholarship awards will integrate an advisor/advocate program for those students.***

All evidence shows that advisor/advocate programs work at all education levels. Many designs are in use across the nation. Private institutions with traditionally high completion rates almost always incorporate a rigorous advisor model. The University of Nevada even aids advisors with a Course Concierge program (see attached article). Some initiatives such as Complete College America presume advisor programs as

evidenced in discussion of retention rate metrics by the statement that colleges “can actively work to better engage those students during their first year....” We heard testimony that University of Alaska Fairbanks (UAF), with mandatory advisors for all degree seekers, has a 5-year completion rate which is 50% higher than University of Alaska Anchorage (UAA) with optional advisors for degree candidates. As the State will be making a significant investment in the scholarship student, the institution receiving the funds should be required to advise the student on how to remain on track toward graduation.

[Murray: I think Seaton is on track here. Just to underscore, this only applies to degree-seeking candidate, which almost all, if not all academic students would be. But even having this requirement for all scholarship students, including AlaskAdvantage recipients might be a good thing.]

- 2. The taskforce should recommend that institutions accepting the scholarship students provide timely course offerings (or a course of study) that allow completion within a two or four year course of study.** This would not guarantee that all students would progress perfectly but would mean that those who desire to move forward would be provided that opportunity. The diversity of methods for providing access to courses for on-time completion has never been more available to Alaska institutions. Programs such as the Western Interstate Commission for Higher Education’s Internet Course Exchange (WICHE ICE) or other programs through cooperating institutions permit students to take courses from the other states’ at no more than 150% of resident tuition. It will be important for all programs requiring more than 60 units for any AA/certificate and more than 120 credits for BA/BS degree programs to provide students the estimation of time for completion so they will know if their scholarship can take them through completion and they can also assess lost opportunity cost by attending that institution.

[Murray: The estimated time completion is an important component, and while the University should strive to see people can graduate in four years, that might be impossible in some cases, and hard in others. To ensure that happens might mean the legislature has to dictate what courses the University offers, especially if they are in non-compliance. And this gets even trickier if they say they are in non-compliance for financial reasons, ie they cannot afford to offer the courses. I am not sure that the legislature can or should dictate what courses the University should offer. This gets into tricky territory.]

- 3. The taskforce should recommend that adequate progress for full-time status as a scholarship student is an accumulation of 30 credits by the start of the sophomore year.** Scholarship students will not require postsecondary non-credit developmental courses, as they have already completed a rigorous high school curriculum with high

Grade Point Average and ACT test scores. Accumulated dual credit, accredited internet and summer school credits should apply. Part-time status should be available if the student did not reach adequate course completion criteria. Momentum toward completion is our best insurance for the success of our State scholarship investment.

[Murray: Thirty credits means a full load for the first two semesters. If a student is having problems, then dropping a course would mean they are no longer eligible for the scholarship. Also it is unclear whether the AlaskAdvantage students would be subject to this as well. Since many would be non-traditional students, as indicated above, this 30-credit requirement could rule them out as well. It would make more sense to require 27 or even 24 credit hours, or to have a process to appeal suspension of the scholarship.]

Needs-Based Assistance

- A Needs-based component should be created/funded to supplement the Merit-based Scholarship. By “supplement”, it is meant that the Needs-based component will be tied and integral to the Merit-based Scholarship, creating a single Merit-/Needs-based program. Under this unified structure, a student would have to be a Scholarship Recipient (having successfully met all residential, curricular, testing, etc. eligibility requirements) to receive needs-based assistance.
- A Needs-based component should be created/funded or identified/used to compliment the Merit-based Scholarship. By “compliment”, it is meant that the Needs-based component will be a stand-alone assistance program, operating independent of the Scholarship, and with eligibility requirements and award protocols not necessarily reflective of those of the Scholarship.
- Understanding the Legislature wishes to further the purposes and goals of the Scholarship, it should work with ACPE to devise a revised AlaskaAdvantage award schema with allows to both continue under its existing ethos but also allows it to reward secondary-school performance (Scholarship recipients) and better incentivize attainment of desired academic outcomes.

Curriculum:

- The Legislature should discard the “alternative” curricular option, retaining only the one originally proposed in the House Education Committee passed HB 297: 4yrs Math, 4yrs Science, 4yrs English, 4yrs Social Studies.
-

[Murray: The senate education committee did this for a reason, but it certainly is not something worth spending too much time on. The up side is that it skews our graduates toward science, math and technology. The down is that it skews our graduates toward science, math and technology.]

- The Legislature should unify the dual-curricular tracks currently available in statute, maintaining the highest level of rigor but also maintaining its “creative” breath (See Louisiana’s TOPS 2014): 4yrs Math, 4yrs Science, 4yrs English, 4yrs Social Studies, 2yrs Foreign/Native Language, 1yr Fine Arts.

[Murray: The four units of math, science, English and Social studies will mean that every year a student has to take these four courses every year. Add the two years of native language and one year of fine arts, AND the required courses in individual schools such as health and PE, and there is little room for any other additional courses. Originally the two years of language was an either/or deal, and you traded two units of math and science for two units of foreign language. If it is doing to be changed, we might want to drop back to the governor’s original formula.]

- To ensure the quality and uniformity of statewide Scholarship curricular offerings, the Legislature should direct, and statutorily allow, the Alaska State Department of Education &

Early Development, in consultation with the Alaska State School Board and any other public or private parties deemed necessary or beneficial, to specify the “required courses” alluded to in statute for each educational category (Ex. 4yrs Math = Algebra 1, Algebra 2, Geometry and Trigonometry) and define the content requirements & standards for those courses in regulations.

[Murray: This gives the department flexibility to determine core course for Voc Ed candidates.]

UA Scholars Program

- Should the University of Alaska, at any time after full implementation of the Scholarship, discontinue the Alaska Scholars Program (ASP), and fail to do so of its own volition, the Legislature should reduce its yearly appropriation to the UA system by the estimated continuation value of the ASP and direct those withheld funds to the Scholarship.

[Murray: UA Scholars money comes from their natural resources fund, which is earnings from land grant trust fund, i.e. money generated from University properties. Currently 100 percent of that money goes to the UA scholars program. Before the UA scholars program this money went to natural resource related programs, such as mining, fisheries, oil and gas, etc. If the program did go down, they would be docked for money that the legislature is not currently giving them.]

SAT/ACT:

- The Legislature should grant the Alaska State Department of Education & Early Development and its Commissioner increased latitude regarding eligibility requirements (particularly SAT/ACT standardized test scores) during the transition phase of programmatic start-up.

[Murray: This allows for the department to adapt to any changes in the national SAT/ACT testing, as well as develop appropriate standards for and Voc Ed programs.]

- The Legislature should direct the Alaska State Department of Education & Early Development to research, devise and/or implement an alternative Scholarship eligibility certification testing regime to serve in replacement or addition to the SAT/ACT.

[Murray: Not a bad idea either. The ACT and SAT have lost some status as the gold standard for college admissions recently. Currently there are more than 700 schools where the SAT/ACT is optional.]

Distance Delivery:

- Recognizing that a robust, reliable distance delivery system is essential to ensuring all students will have a reasonable opportunity to compete for Scholarship awards, the Legislature, in partnership with the State Department of Education, the University of Alaska, and any other public or private parties deemed necessary or beneficial, should do an assessment of the State's existing distance delivery capacity and develop a plan (including cost estimates) for upgrading said system to the required level of capability.

[Murray: This really should be done, whether there is a scholarship or not. The important question is WHO would be doing this assessment. More than once Commissioner LeDoux said that the system was already in place. Others say it is not.]

Scholarship Account:

- The Legislature should create, as a sub-account of the General Fund, an Account specifically designated to receive, hold and distribute monies for the Scholarship.
- The Legislature should initiate and facilitate creation of a Constitutional Fund, separate and distinct from the General Fund, Permanent Fund or Constitutional Budget Reserve Fund, into which monies can be deposited, held and withdrawn to sustain the Scholarship.

Account Capitalization:

- The Legislature should, in a single appropriation using non-descript General Funds (Surplus), immediately capitalize the Scholarship Fund.
- The Legislature should, by liquidating specific existing GF sub-accounts and re-appropriating those funds, immediately capitalize the Scholarship Fund
- The Legislature should incrementally capitalize the Scholarship Fund using non-descript General Funds.
- The Legislature should incrementally capitalize the Scholarship Fund using Designated program receipts and dividends, supplemented as necessary by additional General Funds.
- The Legislature should set the maximum Scholarship Fund value at:
 - \$160 Million
 - \$200 Million
 - \$400 Million
 - Higher
 - No Cap

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
	\$	\$	\$	\$	\$	\$
Appropriation	120,000,000.00	35,000,000.00	35,000,000.00	35,000,000.00	35,000,000.00	35,000,000.00
	\$	\$	\$	\$	\$	\$
Academic	8,221,935.00	14,389,278.00	18,502,029.00	20,556,621.00	20,556,621.00	20,556,621.00
	\$	\$	\$	\$	\$	\$
Needs based	4,000,000.00	7,000,000.00	9,000,000.00	10,000,000.00	10,000,000.00	10,000,000.00
	\$	\$	\$	\$	\$	\$
reinvestmt	107,778,065.00	13,610,722.00	7,497,971.00	4,443,379.00	4,443,379.00	4,443,379.00
	\$	\$	\$	\$	\$	\$
Fund Balance	107,778,065.00	118,166,968.25	129,075,316.66	140,529,082.50	151,998,915.62	164,598,861.40
	\$	\$	\$	\$	\$	\$
Next 10 years	237,702,648.27	254,587,780.68	272,317,169.71	290,933,028.20	310,479,679.61	331,003,663.59

Year 7	Year 8	Year 9	Year 10
\$	\$	\$	\$
35,000,000.00	35,000,000.00	35,000,000.00	35,000,000.00
\$	\$	\$	\$
20,556,621.00	20,556,621.00	20,556,621.00	20,556,621.00
\$	\$	\$	\$
10,000,000.00	10,000,000.00	10,000,000.00	10,000,000.00
\$	\$	\$	\$
4,443,379.00	4,443,379.00	4,443,379.00	4,443,379.00
\$	\$	\$	\$
177,828,804.47	191,720,244.70	206,306,256.93	221,621,569.78
\$	\$	\$	\$
352,553,846.77	375,181,539.11	398,940,616.06	423,887,646.86

The “Next Ten Years” row shows the growth of the fund after the first ten year, but just does not include the specifics of the appropriations and pay outs.

Heather Beaty

From: Murray Richmond
Sent: Thursday, November 04, 2010 5:04 PM
To: Heather Beaty
Subject: Att. Sen. Joe Thomas

Boss,

Here are the graduation requirements for the FNS school district; You'll notice they require 22 and half credits.

If a student takes 4 years of math, science English and Social studies, that is 16 credits. Add to years of foreign language, and that brings it up to 18. Throw in a year of fine arts and we are now at 19. The district requires one and half units of PE and a half unit of health. So add two more and we are now at 21 units. That means that a student would only get to choose one other course (drama, music, yoga, etc) their entire high school career.

Now some electives could come in the social studies block, possibly. For instance, my daughter took Women's history at West, which is probably considered a social studies course. Creative writing would be an English course.

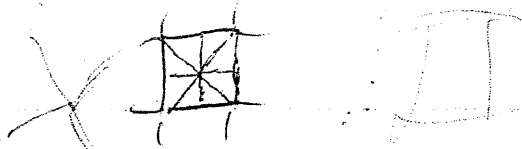
It was recommended that the foreign language be added to the science, math, social studies and English, which might be considered an overload of required courses.

Is this an alternative course of study??

Subject	# of Credits	
English	4	
Social Studies	3-1/2	Alaska Studies required
Science	3	
Mathematics	3	Algebra I required
Physical Education	1-1/2 **	
Health	1/2	
Electives	7	
Total Credits	22-1/2	

Murray Richmond
Legislative Aide
Senator Joe Thomas
(907) 456-8161

11/5/10 Ed. Scholarship Funding



Successful programs become referred in all

Districts & needs based

and award funding to the

Committee

Academic advising & encouraging work

Counseling - information sheets

with needs / conditions are needed

for success.

~~50,000,000~~

400,000 20,000

35,000

365,000 + 15 380,000

35,000

345,000

400,000 put into acct. & each year

will be 30 million ~~in~~ ~~the~~ ~~SS.~~

create
space
for

The interest on 400,000 plus 30 million annual

would build a fund that would be

per sustainability & ~~30 million~~ would be

~~dropped~~ ~~interest~~ after a period of time

that allowed the 400 million to

build to an amount ~~that~~ ~~the~~

earning 5% would support the

40 million / yr plus interest.

269-5602 = Nancy Kordis

(over)

How many ^{college} students that take Education as
as their course, get to the end of
their 4th year & are still at college and/or
in the case of education have to
student ~~for~~ teach which is a point to
decide to work with the student teacher
and so new teachers

**Report to
the
Legisla-
ture,
Fall 2010**

<TARGET><BILL></BILL><SUBJECT>Report to the Legislature, Fall
2010</SUBJECT><COMM>JESF26</COMM></TARGET>

Alaska State Legislature
Joint Legislative Higher Education Scholarship Funding Task Force

Senate

Senator Kevin Meyer, Chair
Senator Johnny Ellis
Senator Lyman Hoffman
Senator Gary Stevens
Senator Joe Thomas



House

Representative Paul Seaton, Vice-chair
Representative Peggy Wilson
Representative Wes Keller
Representative Anna Fairclough
Representative Chris Tuck

Administration

ACPE: Diane Barrans, Director
OMB: Karen Rehfeld, Director
AK State Board of Education: Esther Cox, Chair
University of Alaska: Saichi Oba, Associate Vice President
Department of Education: Eddy Jeans, Education Policy Coordinator

December 1, 2010

Senate President Gary Stevens
State Capitol Room 111
Juneau, AK 99801-1182

Speaker of the House Mike Chenault
State Capitol Room 208
Juneau, AK 99801-1182

Dear President Stevens and Speaker Chenault,

This report is submitted to the Legislature by the Joint Legislative Higher Education Scholarship Funding Task Force, established by the 26th Alaska State Legislature under Senate Bill 221 to "examine higher education costs and identify the best approach in providing financial aid to assist students in the state".

Pursuant to this purpose, the Task Force has spent the interim performing three of the duties outlined in SB 221. These included evaluating how best to provide long-term and sustainable funding for state provided financial aid, evaluating proposals pertaining to financial aid opportunities and taking public comments on financial aid opportunities in the state.

Having completed all these assigned duties, the Task Force now respectfully submits the attached report in fulfillment of its fourth and final duty: "recommend improvements or additions to the laws providing for financial aid at postsecondary institutions." Those recommendations, along with supporting justifications and documentation, as included herein.

Respectfully,

A handwritten signature in cursive script that reads "Kevin Meyer".

Senator Kevin Meyer,
Chairman, Joint Legislative Higher Education Scholarship Funding Task Force

Alaska State Legislature Joint Legislative Higher Education

Scholarship Funding Task Force



Report to the Legislature

Task Force Recommendations on

The Alaska Scholarship Program and

State-supported Educational Financial Assistance

Fall 2010

Executive Summary

Throughout the fall of 2010, the Scholarship Funding Task Force, established by Senate Bill 221 during the 26th Alaska State Legislature, performed an analysis of higher education financial aid policy in an effort to arrive at a set of recommendations for providing financial assistance for the post-high school education and training of Alaska students.

Specifically, the Task Force had been asked to consider options to ensure a long-term and sustainable funding stream for the newly created Alaska Scholarship program (Scholarship) and other state-provided financial aid. To do this, the Task Force solicited input from professionals with knowledge and expertise in education, administration, financial aid and governmental budgeting. It also took public testimony from groups and individuals (including current postsecondary students) who would benefit from or be impacted by the new program. The Task Force performed an in-depth analysis of the existing and potential components of the Scholarship and then, finally, reviewed the budgetary means and mechanisms available to the State to sustain programs like the Scholarship.

In a series of meetings, the Task Force reviewed the legislative history of the Scholarship, from inception to passage into law, and examined the form and function of the merit-based scholarship program created in statute with passage of SB 221. The Task Force also considered needs-based financial aid and examined the State's existing needs-based education assistance program – the AlaskAdvantage education grant program. Finally, the Task Force reviewed the budgetary tools available for supporting state-sponsored programs and analyzed structures the State might use to fund and finance the Scholarship.

Within the context of these reviews, evaluations and analyses, the Task Force formulated a consensus opinion on the funding strategy members agreed would be most efficient and effective in placing the Scholarship on a firm and enduring financial footing. It also considered numerous structural conditions and modifications through which the State's scholarship and financial aid systems might be strengthened to support the optimal functioning of the Scholarship.

This work of the Task Force formed the basis for the following recommendations to the Legislature and the State.

Implementation of these recommendations is expected to provide the structure necessary for the Scholarship to meet its two great promises: Its promise to Alaska that it can raise student academic performance by raising expectations, and its promise to students that, if they challenge themselves and achieve academic success under a highly rigorous curriculum, the State will reward them with a Scholarship.

Summary of Recommendations

Funding and Finance

- The Legislature should immediately create a Scholarship Fund for the Scholarship program.
- If possible, the Scholarship Fund should be immediately capitalized to the point where it can be both self-sufficient and self-sustaining.
- Otherwise, the Scholarship Fund should be incrementally capitalized to a minimum balance of \$160 million using sources which have been positively identified and with revenues that have been affirmatively designated.

Merit-Based Component

Curriculum:

- No immediate amendment should be made to the Scholarship curriculum until its yearly reporting can provide the data to serve as a factual basis for such alterations.
- The Department of Education & Early Development should specify the “required courses” not specifically delineated in statute for each curricular subject area and define the content requirements and standards for those courses.

Distance Delivery:

- The Legislature should do an assessment of the State’s existing distance delivery capacity and, should it be necessary, develop a plan (including cost estimates) for upgrading the Department of Education & Early Development’s capacity to provide virtual program or distance-delivered secondary courses.

Needs-Based Component

- To directly support Scholarship awardees, a capped needs-based supplement should be reintegrated into the Scholarship.
- To assist all students, however, the Legislature should continue its support of the AlaskAdvantage grant program but do so at higher than historic levels.
- The supplemented Scholarship and AlaskAdvantage grant programs should be programmatically separate but should be funded through the same mechanism, under a funding formula which ensures adequate support for both.

Other Policy Recommendations

- Any institution which accepts Scholarship awards should integrate an advisor/advocate program to assist Scholarship awardees in expediting the students’ time to education program completion.

Summary of Recommendations

- Institutions accepting Scholarship awardees should make their best effort to provide course delivery structures that allow for two and/or four year certificate/degree completion timelines.

Introduction

Throughout the fall of 2010, the Joint Legislative Higher Education Scholarship Funding Task Force (hereafter referred to as the “Task Force”), established by Senate Bill 221 during the 26th Alaska State Legislature and in accordance with the Purpose and Duties described therein (Attachment 1), performed an examination of higher education financial aid policy options relative to student success in its effort to arrive at a set of recommendations for providing state financial assistance to Alaska students for post-high school education and training. Specifically, the Task Force was asked to consider options for securing a long-term and sustainable funding stream for the Alaska Scholarship (hereafter referred to as the “Scholarship”), and other state-provided financial aid meant to assist students in attending postsecondary institutions within the State, and to offer guidance to the Legislature on how it might best achieve that goal.

In furtherance of its statutory mandate, the Task Force solicited input from professionals with knowledge and expertise in education, administration, financial aid and governmental budgeting, and took public testimony from impacted groups and individuals, as it performed an in-depth analysis of the existing and potential components of the Scholarship and the means and mechanisms available to the State to sustain it.

The Task Force reviewed the legislative history of the Scholarship (Attachments 2 – 6):

- the Taylor Plan, which served as its preliminary model
- the proposal submitted by the Governor
- the versions created by the House and Senate Education Committees
- the Alaska Performance Scholarship codified in statute today

The Task Force discussed the merit-based component of the Scholarship:

- how students become eligible
- how they apply and the level of awards they can achieve
- where and how recipients can use their scholarships
- how many students are likely to apply for and receive awards
- how much it is likely to cost the State to provide those awards (Attachment 7)

The Task Force discussed the needs-based complement to the Scholarship (Attachment 8):

- the rationale for needs-based assistance
- the proposals on the issue vetted by the Legislature
- the vehicle the Legislature used to mitigate the Scholarship’s lack of an integrated needs-based assistance component - the AlaskAdvantage education grant program
- an estimate of the annual full cost of funding the current AlaskAdvantage grant program to serve as the state’s needs-based assistance component

- potential modification of the AlaskAdvantage grant program to better align it with the student performance goals of the Scholarship

The Task Force discussed the budgetary tools available to the State for funding and financing the Scholarship (Attachment 9):

- the revenues available for appropriation for its support
- the fund and account structures the State can create or maintain to securely hold those funds
- the methods available to the State of ensuring the directed distribution of monies
- the advantages and disadvantages relative to each budgetary structure in relation to the goals of the Task Force

The Task Force analyzed, as representative examples, funding and financing structures submitted to the Task Force (Attachments 10 - 14):

- Two forms of Endowments
- Two Rolling-Account proposals
- the default, annual General Fund appropriation option

Finally, The Task Force discussed ideas for possible “improvements and additions” to the Scholarship, in areas including:

- mandatory curriculum
- assessment alternatives
- access to education programs through distance delivery
- the postsecondary educational system

Having concluded its fact finding and subsequent deliberations, and in accordance with its statutory mandate, the Task Force has generated a list of consensus recommendations regarding the State’s postsecondary financial aid system in general and the Scholarship in particular. Those recommendations, and their supporting rationales, are included in the following report under their corresponding subject heading.

Funding and Finance

The first duty and priority for the Task Force was to “evaluate how best to provide long-term and sustainable funding for state provided financial aid for postsecondary institutions in the state” with particular emphasis being given to the performance-based Alaska Scholarship.

The Task Force analyzed – as representative examples – a number of funding and financing structures which were submitted to the Task Force. Those structures included: heavily capitalized, constitutionally protected endowment funds; heavily capitalized, statutorily created General Fund sub-accounts; moderately capitalized rolling-fund accounts; and, as a control group, the pay-as-you-go default case of annual General Fund appropriations. The Task Force also considered both the numerous revenue sources which could be tapped to provide monies for scholarships and the appropriation mechanisms available for directing such monies to specific programs, as well as the opportunities and challenges associated with each approach.

Relatively speaking, the ideal structure for ensuring a secure, long-term, sustainable funding source for the Scholarship would be a constitutional account, not unlike the Permanent Fund or Constitutional Budget Reserve, specific to the Scholarship and capitalized at a level where revenues generated from investment of the corpus would be sufficient to not only fully fund annual scholarship awards but also sufficient to inflation-proof the fund itself through reinvestment. Though subject to market volatility, such a mechanism (essentially a constitutionally protected endowment) would be highly durable, self-sustaining, more able to attract private donations through the newly augmented education tax-credit system and more likely to provide an adequate, predictable funding stream for the program.

However, such a constitutionally protected endowment account, due to the need for overwhelming legislative support and a further vote of the people, would be difficult and time consuming to create. Another substantial challenge would be capitalizing the account – identifying and appropriating the hundreds of millions of dollars in initial investment necessary to place the fund on the desired self-financing and self-sustaining footing.

One alternative to the constitutionally protected account was reflected in the Governor’s original Scholarship proposal. Senate Bill 224 and House Bill 297 each called for the establishment of a “scholarship fund” - a statutorily created sub-account of the General Fund, to hold appropriations, donations and income earned on investments of fund assets. Such a statutory account would have offered, though to a lesser degree, many of the same benefits as its constitutionally protected counterpart yet, because it could be created through a purely legislative process, would have been far easier to make and could have been established on a timeline as compressed as a single legislative session.

This option, however, suffered from the same fund capitalization shortcomings (both in immediacy and scale) as its counterpart. As described in Fiscal Note 2 of SB 224, the purely

statutory endowment would still have required an initial, immediate, investment of no less than \$400 million to approach fund self-sustainability.

Attempts to mitigate these capitalization challenges resulted in proposals which functionally resembled the revised School Bond Debt Reimbursement program. Under these designs, termed rolling-fund accounts by the Task Force, the fund capitalization threshold was reduced and the investment timeline extended. Under draft legislation requested for the Task Force (Attachments 15 and 16), the Scholarship Fund would be incrementally capitalized up to \$160 million over a series of years as monies were deposited into the fund in excess of those required for distribution as scholarship awards. Such a system would represent a moderate continuing strain on the State's finances but would allow the Legislature to capitalize the fund without the budgetary shock of a large, one-time appropriation. Also, though a smaller account balance would not afford the fail-safe, in perpetuity funding security of a heavily capitalized endowment, the corpus of a rolling-fund would provide a reasonable level of mid-term programmatic funding assurance; allowing the State the potential of a program wind-down while still having sufficient funds to meet its obligations to Scholarship awardees already in the training/education pipeline.

The Task Force considered all of these account options to be preferable to the pay-as-you-go default case of making no specific accommodation for the Scholarship and simply allowing the Administration to submit yearly funding requests for legislative consideration.

Therefore, ***it is the recommendation of the Task Force that the Legislature immediately create, through statute, a Scholarship Fund as a sub-account within the General Fund.*** As an account capitalization goal, ***the Task Force recommends the Scholarship Fund account balance to be an amount sufficient to allow the Scholarship Fund to be wholly self-sustaining both for award distribution and inflation-proofing replenishment.*** As an optimal capitalization strategy, ***the Task Force would prefer, should sufficient funds be available, immediate account capitalization.*** However, recognizing this may not be possible, ***the Task Force recommends, as an alternative, incremental capitalization of the Scholarship Fund to a minimum balance of \$160 million,*** or whatever amount the Legislature deems sufficient for it to act as a surety account for already obligated awards.

Possible funding sources for the Scholarship are many since the State has multiple sources from which it collects revenue (like severance taxes and corporate income taxes), multiple ways it generates income (like investment returns, dividends and program receipts) and dozens of existing accounts in which it is already holding money. Much of this income flows into the General Fund and is as available for appropriation to the Scholarship as it is for any other state program.

However, relying primarily on General Funds for support of a program is to subject it to the uncertainty of the budgetary process by placing it in competition with all other programs for yearly legislative prioritization and appropriation. This is a situation the Task Force, with an

overarching interest in assuring an adequate, secure and predictable funding stream to the Scholarship, would hope to avoid. Therefore, the Task Force advocates a funding regime which would require General Funds as supplemental funds only, if at all.

In general, and as much as is practicable, ***the Task Force recommends that sources of funding for the Scholarship by positively identified, “funds-in” revenue be affirmatively designated*** and General Funds be used as necessary and in supplement only. In order of preference, from “first place to go” to last, the Task Force advises the Legislature to fund the Scholarship Fund as follows:

1. Designating Interest from Specific, Existing Accounts
2. Designating Program Receipts and Dividends
3. Designating Revenues from Specific, External Sources
4. Re-appropriated Assets from Liquidated Accounts
5. General Funds

Merit-based Component

Curriculum

It is the intent of the Scholarship (Attachment 17), through “increased academic rigor”, to improve the academic performance of Alaska students in grades kindergarten through 12 and thereby improve preparedness for postsecondary education and successful performance at postsecondary educational institutions. As such, many Task Force discussions focused on the dual curricular offerings embedded in the codified Scholarship.

To some, the inclusion of a “liberal arts” option, allowing for the taking of three years of mathematics, four years of language arts, three years of science, four years of social studies, and two years of a foreign language or Alaska Native language, represented a diminishment of programmatic rigor, and it was argued that the State should return to the single curricular option described in House Bill 297. To others, the inclusion of the two curricular options better reflected the reality of individual scholastic propensity and represented no such diminishment.

Recognizing that other states, with longer established Taylor Plan-based scholarship programs, have wrestled with this issue, and that future adjustments regarding these broad curricular categories are always within the State’s power, ***the Task Force recommends making no immediate amendment to the curricula of the Scholarship until its yearly reporting can provide the data to serve as a factual basis for alteration.***

The Task Force does, however, further recognize that broad statements regarding years of required schooling by discipline are relatively meaningless, and the State’s goal of increasing academic proficiency is less likely to achieve success, without a clearer definition of precisely what courses are to be taken and what content is expected to be taught and learned. Succinctly, course rigor is dependent on content not course titles. Therefore, to ensure the quality and uniformity of statewide Scholarship curricular offerings, ***the Task Force recommends the Legislature direct, and statutorily allow, the Alaska State Department of Education & Early Development, in consultation with the Alaska State School Board and any other public or private parties deemed necessary or beneficial, to specify the required courses not specifically delineated in statute for each educational category*** (Ex. 4yrs Math = Algebra 1, Algebra 2, Geometry and Trigonometry, etc.) ***and define the content requirements and standards for those courses in regulation.*** Although the State might experience resistance to such a move, the voluntary nature of the Scholarship vis-à-vis student curricular choices, coupled with the size of the State’s required investment and the customary ability of scholarship sponsors to set whatever requirements it feels most likely to achieve its desired ends, are compelling justifications for such a move.

Distance Delivery

There is concern the State, due to a lack of physical infrastructure and/or virtual secondary-level educational content, may currently be unable to deliver, on a consistent basis, all facets of the rigorous curriculum required by the Scholarship to all students in all locations throughout Alaska. Therefore, recognizing that a robust, reliable distance delivery system is essential to ensuring all students will have a reasonable opportunity to compete for Scholarship awards, and to ensure equity in the Scholarship Program, ***the Task Force recommends the Legislature, in partnership with the State Department of Education and Early Development, the University of Alaska, and any other public or private parties deemed necessary or beneficial, do an assessment of the State's existing distance delivery capacity and, should it be necessary, develop a plan (including cost estimates) for upgrading the Department's capacity to provide virtual program or distance-delivered secondary courses.***

Needs-Based Component

The original scholarship proposal (SB 224/HB297), as submitted, provided only for merit-based financial assistance but was later amended to include a needs-based component that was supplemental to the merit-based Scholarship. By supplemental, it is meant that the needs-based component was integrated within the merit-based Scholarship, creating a single program whereby a student would have to be a Scholarship recipient to be eligible to receive needs-based assistance. The goal of integrating a needs-based component into the merit scholarship was to ensure that the lesser socio-economically advantaged students who qualified for the merit scholarship would have the ability to use their merit-based award.

However, the statute that created the Scholarship (SB 221) used the AlaskAdvantage education grant program – an existing, stand alone program which, as a function of historic funding levels, had only been able to provide grants to those students demonstrating the highest level of financial need based on the methodology used in the Free Application for Federal Student Aid: primarily non-traditional, older students - to address the possible necessity for added assistance by Scholarship awardees specifically and the acknowledged insufficiency of state-funded needs-based financial assistance in Alaska generally.

This was not a perfect fit as these programs were not designed to work in concert and generally target groups which are not aligned. The AlaskAdvantage grant program has much broader eligibility standards than the Scholarship. Seeking to make the Scholarship's qualifications the same as for AlaskAdvantage would greatly impair, or even eliminate, its efficacy related to its broad-based programmatic goals just as seeking to amend AlaskAdvantage education grant's qualifications to mirror those of the Scholarship would render it unavailable to many of the groups it currently serves. However, the Task Force recognizes the value of the programs, their complementary natures and the statewide benefit of maintaining them both.

Therefore, ***the Task Force recommends the creation of a second needs-based assistance program: a needs-based component, similar or identical to the one proposed in Education Committee versions of SB224/HB297, to be reintegrated into the Scholarship.*** Such a supplement will allow the Scholarship to more fully serve its high achieving, traditional student population. However, recognizing the indeterminate funding liability potential of the need-based supplement, ***the Task Force recommends the integrated needs-based component be capped***, either at a 2010 amount of \$4,755 (as the merit-based portion of the Scholarship award has been capped at the 2010 UA tuition amount) or some other reasonable figure. ***The Task Force further recommends continued funding, at a level commensurate with its full functioning, of the AlaskAdvantage grant program***, allowing it to serve the non-traditional, General Education Development (GED), and older students as prioritized for grants under the program's current criteria. Finally, though they are to be programmatically separate, ***the Task***

Force recommends the supplemented Scholarship and AlaskAdvantage grant programs be funded through the same mechanism, perhaps, though not necessarily, under a funding formula which will ensure adequate support for both.

Other Policy Recommendations Regarding Scholarship Investments

It is recognized that remedial courses delivered at the postsecondary level may entail public and/or private expense but do not count for degree credit. Also, by delaying progress toward completion, the need for remediation substantially reduces the probability a student will ever complete a degree/certificate program. Therefore, a goal of the Legislature in establishing a merit scholarship program was to create a source of transformational pressure on Alaska's K-12 system - a renewed impetus for it to adequately prepare students for successful entry into college and career/tech - and, in so doing, ensure scholarship awardees will not need to expend time or personal capital on developmental education (remedial) courses.

Degree/certificate completion – not simply attendance – is the investment objective of the State. It should therefore look at factors that produce delay in progress or otherwise contribute significantly to non-completion. What other policies should be instituted in the scholarship program to stimulate postsecondary education changes to incentivize completion and make our money count? On-time completion will also become vital to Alaska institutions as a scholarship program becomes fully implemented because the anticipated growth in student enrollment may well overwhelm available capacity if students do not progress more rapidly. The following suggestions are programmatic recommendations to advance that goal:

The Task Force recommends that any institution which accepts Scholarship awards should integrate an advisor/advocate program to assist Scholarship awardees.

Evidence shows that advisor/advocate programs work at all education levels. Many designs are in use across the nation. Private institutions with traditionally high completion rates almost always incorporate a rigorous advising model. The University of Nevada even aids students through a Course Concierge program (Attachment 18). Some initiatives such as Complete College America presume advising programs as evidenced in discussion of retention rate metrics by the statement that colleges “can actively work to better engage those students during their first year....” The Task Force heard testimony that University of Alaska Fairbanks (UAF), with mandatory advising for all degree seekers, has a five-year completion rate which is 50% higher than University of Alaska Anchorage (UAA) with optional advising for degree candidates. As the State will be making a significant investment in the scholarship student, it is reasonable for the State to request that institutions receiving those funds advise that student on how to remain on track toward graduation.

The Task Force recommends that institutions accepting Scholarship awardees should assist them in maximizing the value of their awards by providing timely course offerings (or courses

of study) that allow for completion of certificate and/or degree programs within a two- or four-year course of study.

This would not guarantee that all students would progress perfectly but would mean that those who desire to move forward would be provided that opportunity. The diversity of methods for providing access to courses for on-time completion has never been more available to Alaska institutions. Programs such as the Western Interstate Commission for Higher Education's Internet Course Exchange (WICHE ICE) or other programs through participating institutions permit students to take courses not otherwise available to them. It will be important for all programs requiring more than 60 units for an AA certificate and more than 120 credits for a BA/BS degree to provide students the estimation of time for completion so they can reasonably assess the probability of their Scholarship funding their education through completion and make further arrangements as appropriate or necessary.

Scholarship Funding Task Force Report to the Legislature

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Attachment 1

Joint Legislative Higher Education Scholarship Funding Task Force

Membership:

Chair: Senator Meyer
Vice-chair: Representative Seaton

Senate

Senator Johnny Ellis
Senator Lyman Hoffman
Senator Gary Stevens
Senator Joe Thomas

House

Representative Peggy Wilson
Representative Wes Keller
Representative Anna Fairclough
Representative Chris Tuck

Administration

Department of Education: Eddy Jeans, Education Policy Coordinator
University of Alaska: Saichi Oba, Associate Vice President
OMB: Karen Rehfeld, Director
ACPE: Diane Barrans, Director
AK State Board of Education: Esther Cox, Chair

Purpose: Examine higher education costs and identify the best approach in providing financial aid to assist students in the state.

Duties:

- Evaluate how best to provide long-term and sustainable funding for state provided financial aid for postsecondary institutions in the state, including scholarship opportunities
- Evaluate proposals that are based on available facts and conclusions pertaining to financial aid opportunities at postsecondary institutions in the state.
- Recommend improvements or additions to the laws providing for financial aid at postsecondary institutions.
- Take public comments on financial aid opportunities in the state.

Attachment 2

TAYLOR PLAN – Louisiana (2014 Graduates)

*CURRICULUM**

Four (4) years of math

Four (4) years of Language Arts

Four (4) years of Science

Four (4) years of Social Studies

One (1) year Fine Arts

Two (2) years Foreign Language

*Specific required courses spelled out in publications

MINIMUM ACHIEVEMENT

- 2.5 or higher cumulative GPA
- Composite ACT of 20 or above

STANDARD AWARD

State-paid tuition at any public two- or four-year college, university or vocational/technical school or equivalent award at any in-state private institution.

ADDITIONAL AWARDS

- \$400 for students with a GPA of 3.5 or better, and ACT of 23 or higher
- \$800 for students with a GPA of 3.5 or better, and ACT of 27 or higher

Attachment 3

GOVERNOR'S PERFORMANCE SCHOLARSHIP

QUALIFICATIONS OF APPLICANTS

- Alaska Residents who have applied, or will apply, no more than six (6) months before or after date of graduation.
- Will use the scholarship at a qualified (Alaskan) post secondary institution no later than 6 years after the beginning of the first school year after graduation.

ELIGIBILITY

- Completed Core Curriculum
- Met minimum grade-point average threshold
- Met minimum career-skills assessment or college entrance examination threshold
- Be enrolled in a certificate or degree-seeking program

CURRICULUM*

Four (4) years of math

Four (4) years of Language Arts

Four (4) years of Science

Three (3) years of Social Studies

*Specifics TBA

AWARD LEVELS* **

- 3.5 and up - 100% of qualified tuition
- 3.0-3.49 - 75% of qualified tuition
- 2.5-2.99 - 50% of qualified tuition

*Minimum test scores per tier, and how they would impact awards, TBA

**Career Scholarship award not to exceed \$3,000 per school year

ESTIMATED PROGRAMMATIC COST

FY 2012 - \$8,221,935

FY 2016 - \$20,556,621

Attachment 4

SENATE EDUCATION COMMITTEE

QUALIFICATIONS OF APPLICANT

- Alaska Residents who have applied, or will apply, no more than six (6) months before or after date of graduation.
- Will use the scholarship at a qualified (Alaskan) post secondary institution no later than 6 years after the beginning of the first school year after graduation.

ELIGIBILITY

- Completed Core Curriculum
- Met minimum grade-point average threshold
- Met minimum career-skills assessment or college entrance examination threshold
- Be enrolled in a certificate or degree-seeking program

CURRICULUM*

Four (4) years of math

Four (4) years of Language Arts

Four (4) years of Science

Four (4) years of Social Studies, one may include a non-English language, art, etc.

Three (3) years of math

Four (4) years of Language Arts

Three (3) years of Science

Four (4) years of Social Studies

Two (2) years of foreign or Alaska Native language

*Specifics TBA

AWARD LEVELS* **

Academic

- 3.5 and up - 100% of qualified tuition
- 3.0-3.49 - 75% of qualified tuition
- 2.5-2.99 - 50% of qualified tuition

Need

- 50% of outstanding "unmet financial need" after grants, awards and \$2,000 student contribution

*Minimum test scores per tier, and how they would impact awards, TBA

**Career Scholarship award not to exceed \$3,000 per school year

ESTIMATED PROGRAMMATIC COST

FY 2012 - \$25,341,600*

FY 2015 - \$40,106,600

*Reflects inclusion of 2010 graduates in first cohort

Attachment 5

HOUSE EDUCATION COMMITTEE

QUALIFICATIONS OF APPLICANTS

- Alaska Residents who have applied, or will apply, no more than six (6) months before or after date of graduation.
- Will use the scholarship at a qualified (Alaskan) post secondary institution no later than 6 years after the beginning of the first school year after graduation.

ELIGIBILITY

- Completed Core Curriculum
- Met minimum grade-point average threshold
- Met minimum career-skills assessment or college entrance examination threshold
- Be enrolled in a certificate or degree-seeking program

*CURRICULUM**

Four (4) years of math

Four (4) years of Language Arts

Four (4) years of Science

Three (3) years of Social Studies

*Specifics TBA

AWARD LEVELS ***

Academic

- 3.5 and up - 100% of qualified tuition
- 3.0-3.49 - 75% of qualified tuition
- 2.5-2.99 - 50% of qualified tuition

Need

- 50% of outstanding "unmet financial need" after grants, awards and \$2,000 student contribution

*Minimum test scores per tier, and how they would impact awards, TBA

**Career Scholarship award not to exceed \$3,000 per school year

ESTIMATED PROGRAMMATIC COST

FY 2012 - \$14,480,000

FY 2016 - \$37,169,600

Attachment 6

ALASKA SCHOLARSHIP PROGRAM

QUALIFICATIONS OF APPLICANTS

- Alaska Residents who have applied, or will apply, no more than six (6) months before or after date of graduation.
- Will use the scholarship at a qualified (Alaskan) post secondary institution no later than 6 years after the beginning of the first school year after graduation.

ELIGIBILITY

- Completed Core Curriculum
- Met minimum grade-point average threshold
- Met minimum career-skills assessment or college entrance examination threshold
- Be enrolled in a certificate or degree-seeking program

CURRICULUM*

Four (4) years of math

Four (4) years of Language Arts

Four (4) years of Science

Four (4) years of Social Studies, one may include a non-English language, art, etc.

Three (3) years of math

Four (4) years of Language Arts

Three (3) years of Science

Four (4) years of Social Studies

Two (2) years of foreign or Alaska Native language

*Specifics TBA

AWARD LEVELS*

Academic

- 3.5 and up - \$4,755
- 3.0-3.49 - \$3,566
- 2.5-2.99 - \$2,378

Need

- \$400,000 one-time appropriation to AlaskAdvantage to accommodate increased maximum award

*Minimum test scores per tier, and how they would impact awards, TBA

ESTIMATED PROGRAMMATIC COST

FY 2012 - \$9,321,900

FY 2016 - \$21,656,600

Attachment 7

Department of Education Updated Scholarship Cost Estimate – 8/17/10:

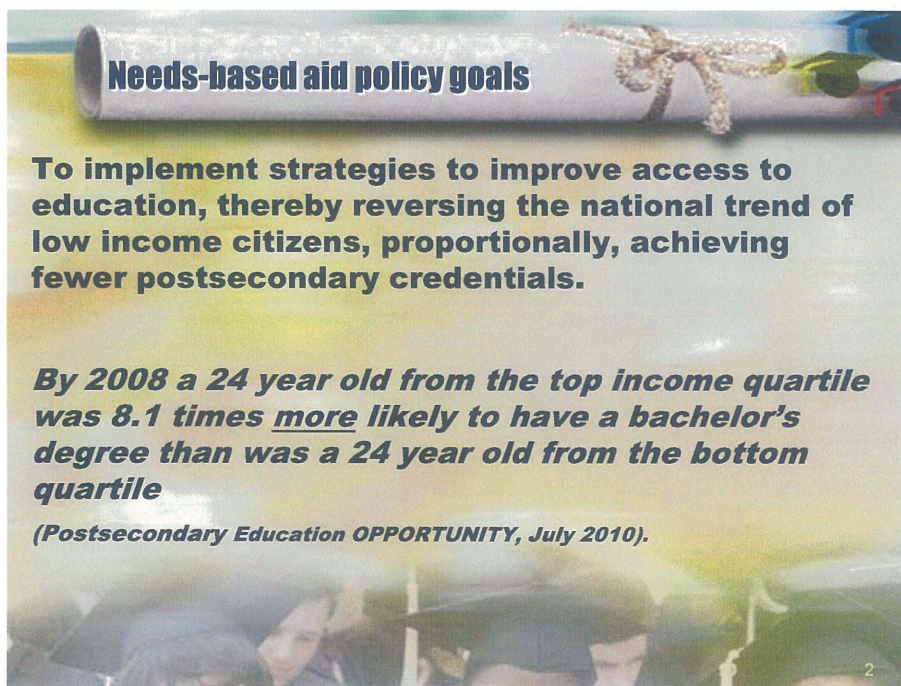
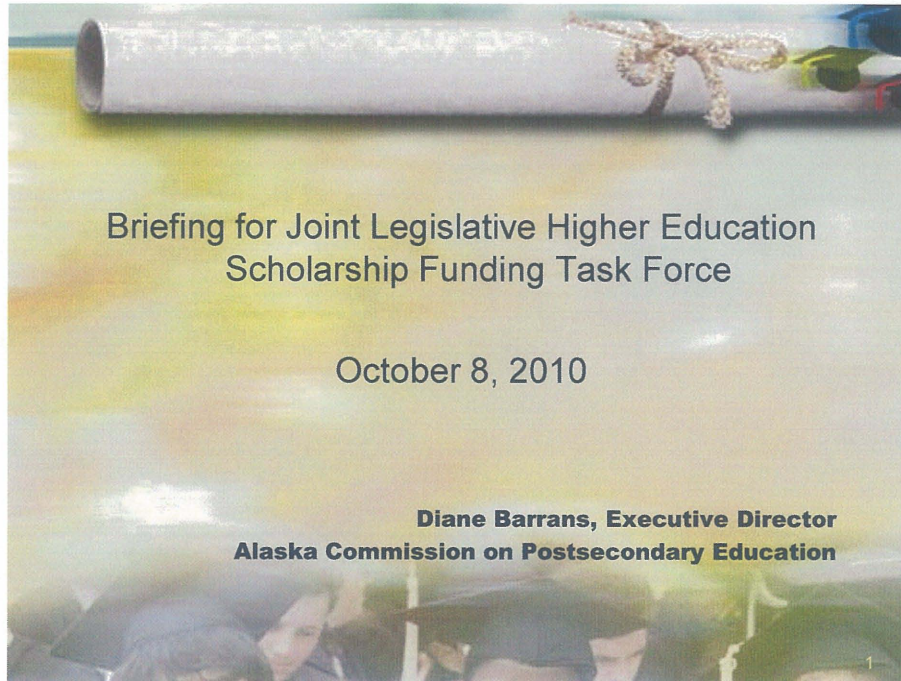
District_Name	2010 Graduates	3.5 +	3.0-3.49	2.5-2.99	3.5 +	3.0-3.49	2.5-2.99	Percentage of Graduates with GI 2.5 or better	
North Slope Borough School District	81	9	19	23	11.11%	23.46%	28.40%	62	
Northwest Arctic Borough School District	99	16	19	19	16.16%	19.19%	19.19%	54	
Petersburg City School District	38	8	18	8	21.05%	47.37%	21.05%	89	
Matanuska-Susitna Borough School District	1,092	233	234	269	21.34%	21.43%	24.63%	67	
Kenai Peninsula Borough School District	666	171	173	150	25.68%	25.98%	22.52%	74	
Juneau Borough School District	356	94	70	68	26.40%	19.66%	19.10%	65	
Fairbanks North Star Borough School District	889	213	193	219	23.96%	21.71%	24.63%	70	
Anchorage School District	3,082	714	681	742	23.17%	22.10%	24.08%	69	
				Averages	19.78%	26.39%	23.45%	69	
Total Statewide Graduates 2010	8,256	Estimated number of Students on GPA			1,633	2,179	1,936		
Est # students eligible and using Scholarship	2,244	5 yr avg # of students ACT cuts			29.31%	12.14%	12.87%		
% of graduates utilizing scholarship	27.2%	Estimated number of Students on ACT			2,420	1,002	1,063		
				Difference between ACT and GPA	787	-1,177	-873		
Scholarship Type >>>					Honors	Achievement	Opportunity		
Estimated number of students eligible for scholarships by category					1,633	1,789	1,063		
Variable for eligible students >>>>					Percentage of eligible students using scholarship	50%	817	895	532
					scholarship rates	\$4,755	\$3,566	\$2,378	Estimated
						\$3,884,835	\$3,191,570	\$1,265,096	\$8,341,501

According to Education Trust, the average graduation rate for 5 year graduation for UAF is 25% and UAA is 16.5%. The four year graduation rate is significantly lower.

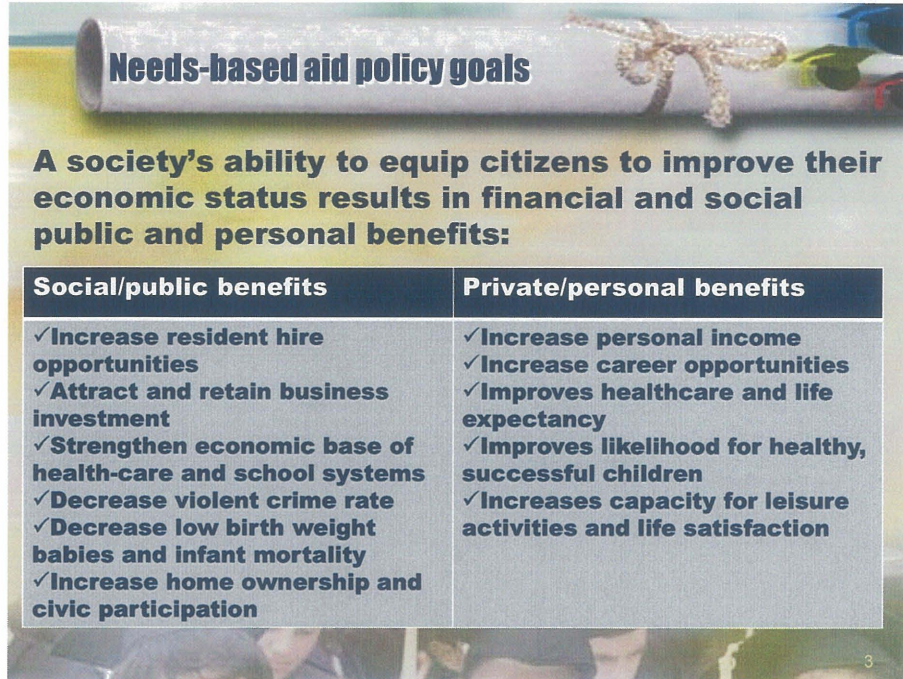
	Participation rates	number of Students	Est. annual cost	Year 1 Estimated cost	Year 2 Estimated cost	Year 3 Estimated cost
Year 1	100%	2,244	\$8,341,501	\$8,341,501		
Year 2	75%	1,683	\$6,256,126		\$14,597,627	
Year 3	50%	1,122	\$4,170,751			\$18,768,378
Year 4	25%	561	\$2,085,375			
Estimated annual cost when fully implemented		5,610	\$20,853,753			

Attachment 8

ACPE Needs-Based Assistance Presentation:



Attachment 8

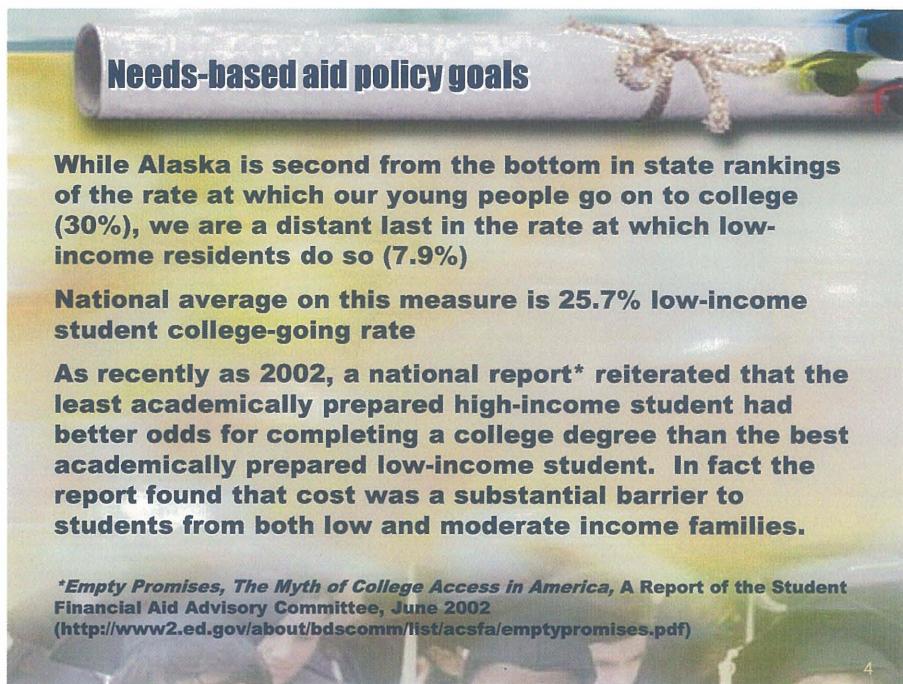


Needs-based aid policy goals

A society's ability to equip citizens to improve their economic status results in financial and social public and personal benefits:

Social/public benefits	Private/personal benefits
<ul style="list-style-type: none">✓ Increase resident hire opportunities✓ Attract and retain business investment✓ Strengthen economic base of health-care and school systems✓ Decrease violent crime rate✓ Decrease low birth weight babies and infant mortality✓ Increase home ownership and civic participation	<ul style="list-style-type: none">✓ Increase personal income✓ Increase career opportunities✓ Improves healthcare and life expectancy✓ Improves likelihood for healthy, successful children✓ Increases capacity for leisure activities and life satisfaction

3



Needs-based aid policy goals

While Alaska is second from the bottom in state rankings of the rate at which our young people go on to college (30%), we are a distant last in the rate at which low-income residents do so (7.9%)


National average on this measure is 25.7% low-income student college-going rate

As recently as 2002, a national report* reiterated that the least academically prepared high-income student had better odds for completing a college degree than the best academically prepared low-income student. In fact the report found that cost was a substantial barrier to students from both low and moderate income families.

*Empty Promises, The Myth of College Access in America, A Report of the Student Financial Aid Advisory Committee, June 2002
(<http://www2.ed.gov/about/bdscomm/list/acsfa/emptypromises.pdf>)



4

Attachment 8



Alaska's state financial aid policy goals

By *combining strategies* of needs-based and performance-based financial aid opportunities, Alaska's governor and legislature are utilizing two components that are each critical to Alaskans' access to and success in postsecondary education—academic and financial capacity.





2010 Legislative models

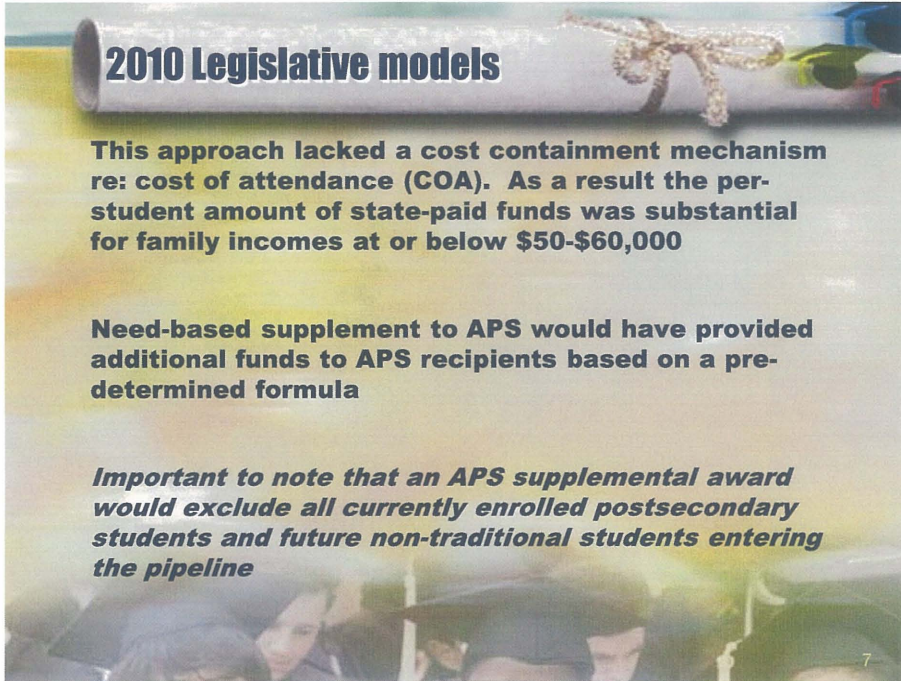
HB297(EDC)/SB224(EDC) entitled scholarship recipients to an additional 50% of unmet cost of attendance (COA) > \$2,000

B-level Award Distribution by Family Income Level

Family AGI	\$25,000	\$50,000	\$75,000	\$100,000
Cost of attendance	\$18,500	\$18,500	\$18,500	\$18,500
Less Pell grant	-\$5,550	-\$0	-\$0	-\$0
Remaining costs	\$12,950	\$18,500	\$18,500	\$18,500
Less APS award	-\$3,566	-\$3,566	-\$3,566	-\$3,566
Remaining costs	\$9,385	\$14,934	\$14,934	\$14,934
Less EFC+\$2,000	-\$2,000	-\$6,772	-\$14,157	-\$15,401
Unmet need	\$7,384	\$8,212	\$777	\$0
Less needs award @ 50%	-\$3,692	-\$4,106	-\$388	\$0
Remaining family costs	\$3,692	\$4,106	\$389	\$0
Total State aid	\$7,258	\$7,672	\$3,954	\$3,566
Total student & family paid costs	\$5,692	\$10,878	\$14,546	\$15,401



Attachment 8



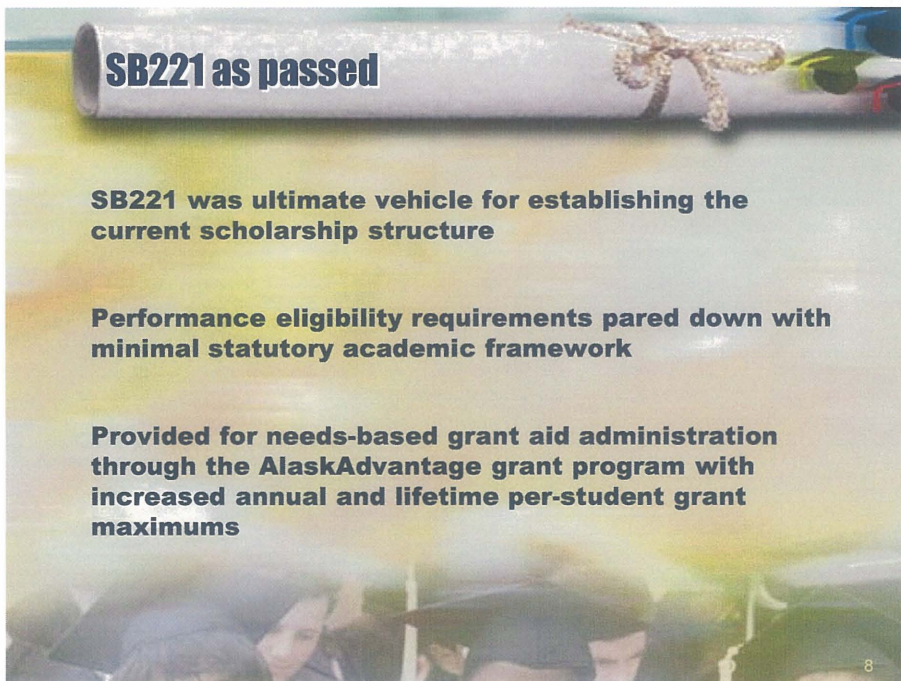
2010 Legislative models

This approach lacked a cost containment mechanism re: cost of attendance (COA). As a result the per-student amount of state-paid funds was substantial for family incomes at or below \$50-\$60,000

Need-based supplement to APS would have provided additional funds to APS recipients based on a pre-determined formula

Important to note that an APS supplemental award would exclude all currently enrolled postsecondary students and future non-traditional students entering the pipeline

7



SB221 as passed


SB221 was ultimate vehicle for establishing the current scholarship structure

Performance eligibility requirements pared down with minimal statutory academic framework

Provided for needs-based grant aid administration through the AlaskAdvantage grant program with increased annual and lifetime per-student grant maximums

8


Attachment 8




SB221 as passed

Fiscal Note passed to provide FY11 funding in the amount of \$400,000 to supplement approximately \$980,000* remaining from FY09 capital budget and \$122,400 in federal LEAP/SLEAP funds

***This amount is higher than previously estimated due to a lower than expected FY10 grant award use**



9




Current grant criteria

Alaska resident enrolled at least half time in a certificate or degree program at a regionally or nationally accredited school in Alaska

Meet institution's satisfactory academic progress requirements

Demonstrate financial need based on the methodology used in the Free Application for Federal Student Aid



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Attachment 8

Current grant criteria

Meet other criteria to receive federal financial aid (not already have an undergraduate degree, registered for the draft, no drug convictions while receiving aid, etc.)

Have a high school diploma or GED

Have unmet need of at least \$500 after all other non-loan financial aid considered

Applicant pool is all otherwise eligible students who file a FAFSA on or before April 15

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Current award process

Applicant information is made available to schools students have listed on their FAFSAs

Schools provide information about other financial aid awarded and verify enrollment

Using a set standard cost of attendance (based on current year UA COA), ACPE reduces the COA by each student's other non-loan aid and the Estimated Family Contribution (EFC)

Standard COA

- Other non-loan aid

- EFC

= Unmet need

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Attachment 8

Current award process

Applicants are then sorted, by unmet need amounts, in a descending order

ACPE makes awards until the available funds are exhausted

In the event of equivalent unmet need amounts, two additional ordering criteria are:

- 1) lowest adjusted gross income; and,**
- 2) closest to program completion**

13

Current grant structure

AlaskAdvantage priority awards

Program rules provide for priority awards, in the form of higher grant amounts, for students in two categories:

- 1. Enrolled in severe workforce shortage area programs, or**
- 2. Having secondary school performance demonstrate high likelihood for postsecondary education success**

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Attachment 8

Current grant structure

For category one, the Commission annually determines qualifying shortage programs and they are:

1. education,
2. protective and social services,
3. allied health, and
4. process and resource extraction industries

For category two, by regulation, eligibility is based on having scored in the top quartile of test takers on either the SAT or ACT (1740/24)

15


Current grant amounts

Award type	Full-time student	Half-time student
Standard Award	\$1,500	\$750
Workforce Shortage Award	\$3,000	\$1,500
Top quartile of SAT/ACT test takers scores	\$3,000	\$1,500

(All amounts shown for full academic years)

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Attachment 8



Program funding history


Grant funding source since current program inception in 2005-06: federal S/LEAP funds, ASLC Ofee account interest, FY09 capital appropriation

Until FY09 annually funded at approximately \$650,000


Most recent 3-year average total awarded is \$1.161 million

Over five years number of AK FAFSA filers is up 70% with greater increases in the number of grant-eligible applicants

Because demand has outstripped funding, only applicants with very high need have been funded



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Population served in 2009-2010

Population characteristics	Alaska FAFSAs	Eligible population	Awarded	Certified & disbursed
# of students	17,284	4,960	1,543	870
Average Age	27.8	27.7	30.3	32.6
Average AGI	\$53,954	\$34,994	\$18,527	\$16,617
Average unmet need	\$8,333	\$10,966	\$14,965	\$14,538

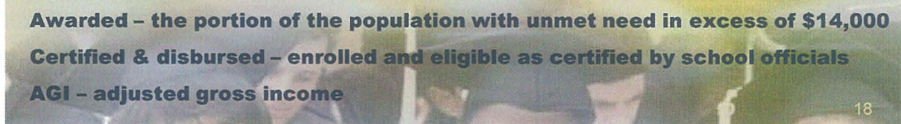
Alaska FAFSAs - number of Alaska resident filers for attendance at Alaska schools

Eligible population - a total population subset having filed by the April 15 deadline, indicating enrollment at a participating school and w/unmet need of \$500 or greater

Awarded - the portion of the population with unmet need in excess of \$14,000


Certified & disbursed - enrolled and eligible as certified by school officials

AGI - adjusted gross income



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Attachment 8



Estimating full funding

Using FY10 program year data, full funding, if the base grant amount is increased to the full \$3,000, is estimated to be \$8.5 million

Assuming eligible pool will grow by 20% due to increase in first-time freshman entering UA and that these students will be grant-eligible @ at same rate (69%)


Fall 09 Freshman (Alaskans/headcount) – 3,352*

Fall 09 Freshman (recent HS grads) – 2,355*


EED estimates of students eligible & using APS – 2,244

Anticipate slow growth over time in demand on grants as a result of APS's transformational impact

*(Source) UA in Review 2010



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Considerations for alternative approaches

Relative to other needs-based structures, program terms and conditions are determined specific to goals

For goal of equity and broad access, the current AlaskAdvantage grant program is the simplest model because it is most inclusive


To incent and reward academic achievement, additional requirements could be imposed either for: continued grant eligibility or increased grant amounts/priority grant eligibility in subsequent years

Similarly, to incent accelerated progress to certificate/degree, grant eligibility could require full-time enrollment and additional performance or progress-to-degree requirements could apply



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Attachment 8




Considerations for alternative approaches

Program designers should be mindful of consequences of terms and conditions that exclude populations which could benefit most from postsecondary education


These populations may include:

- GED recipients
- Non-traditional adults seeking to upgrade or acquire new skills/education

Another important consideration is the level of complexity and cost certain terms and conditions can impose on students, schools, or program administrators



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Considerations for alternative approaches

Relative to program costs, containment mechanisms may include:

- Using fixed dollar award amounts**
- Establishing household income cut-off levels (ex: 150/200% of poverty levels)**
- Cap funding level and continue to award from greatest to least needs levels**

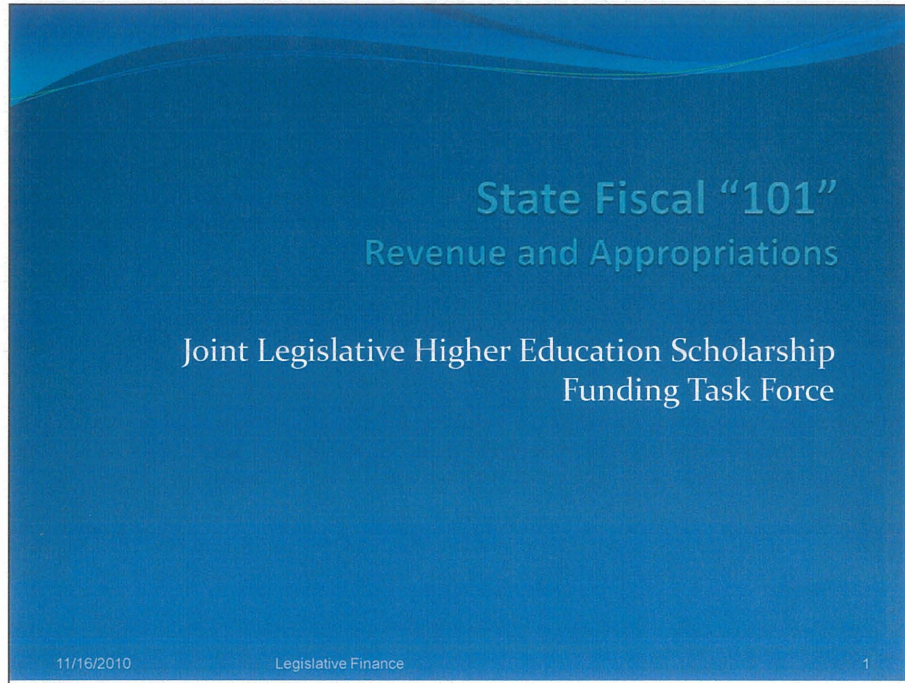
Questions/Discussion



22

Attachment 9

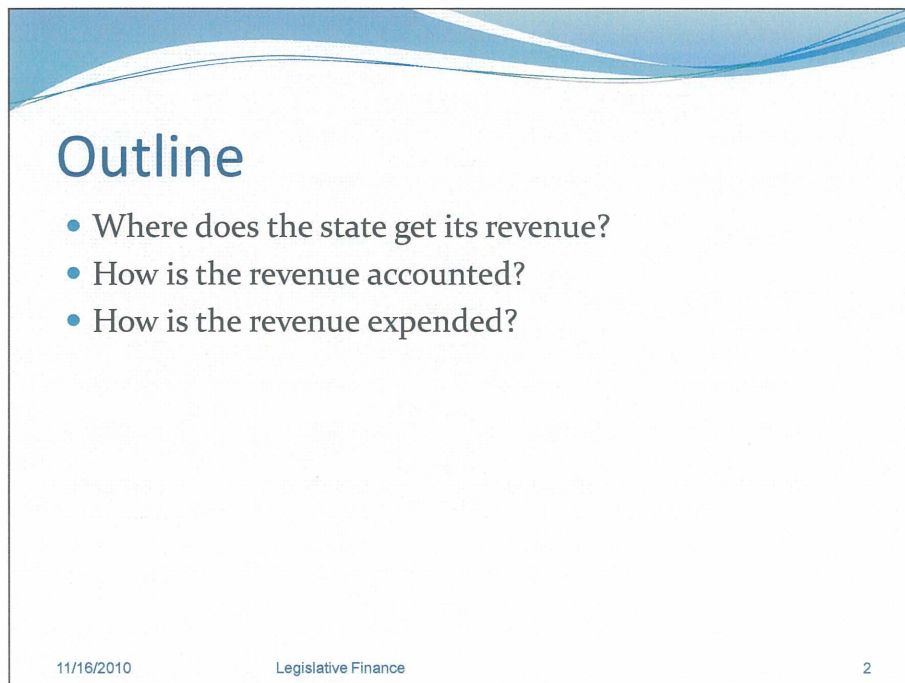
Legislative Finance *State Fiscal "101"* Presentation:



State Fiscal "101"
Revenue and Appropriations

Joint Legislative Higher Education Scholarship
Funding Task Force

11/16/2010 Legislative Finance 1



Outline

- Where does the state get its revenue?
- How is the revenue accounted?
- How is the revenue expended?

11/16/2010 Legislative Finance 2

Attachment 9

Revenue Sources

- Oil
- Non-Oil (excluding Investment)
- Investment
- Federal

11/16/2010

Legislative Finance

3

Oil Revenue

- Royalty
 - Leasing of state land and royalty payment as land owner
- Production Tax
 - Net profits tax on production
- Petroleum Property Tax
 - Property tax on oil and gas property in state
- O&G Corporate Income Tax
 - Income tax on oil and gas corporations

11/16/2010

Legislative Finance

4

Attachment 9

Non-Oil (excluding investment)

- Corporate Income Tax (non-oil companies)
- Excise Taxes
 - Tobacco, alcoholic beverages, motor fuel
- Licenses and Permits
 - Fishing Hunting, Motor Vehicle
- Charges for Services
 - Marine Highway, other program receipts

11/16/2010

Legislative Finance

5

Investment Income

- GF Earnings (relatively new)
- CBR
- Permanent Fund

11/16/2010

Legislative Finance

6

Attachment 9

How is revenue accounted?

- The primary operating fund of the state is the General Fund
 - The general fund has numerous sub-funds created by law
- Other fund types outside the general fund include (but not limited to):
 - Permanent Funds
 - Fiduciary Funds
 - Component Units

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Legislative Finance

7

Accounting ≠ Budgeting

Both accounting and budgeting are fiscal systems

- Accounting focuses on recording financial transactions
- Budgeting is more the enactment of a fiscal plan
 - Budget processes are dependent upon the accounting of past and current year expenditures and revenue
- Accounting follows generally accepted accounting practices (GASB)
- Budgeting does not follow a stringent set of rules

11/16/2010

Legislative Finance

8

Attachment 9

How is revenue expended?

- Legislature has the **Power of Appropriation**
 - No expenditure of state funds w/o an appropriation
- Legislature appropriates funds based on levels of discretion

11/16/2010

Legislative Finance

9

Levels of Discretion (Highest to Lowest)

Fund sources (revenues) grouped according to levels of discretion

- Unrestricted General Funds
- Designated General Funds
- Other State Funds
- Dedicated Funds

11/16/2010

Legislative Finance

10

Attachment 9

Dedicated

- Very little discretion how appropriated
- Article IX, Section 7 of the Constitution prohibits the dedication of revenue to any special purpose
 - Exceptions:
 - Article IX, Section 15 – Permanent Fund
 - Dedication prior to Statehood
 - Federal

11/16/2010

Legislative Finance

11

Other State Funds

- Little discretion how appropriated
- Although not dedicated, funding sources in the group typically are restricted in some fashion
 - Contractual obligation
 - Bonds
 - Held in trust
 - PERS, TRS, etc.
 - Court order
 - Mental Health Trust
 - Legal separation
 - Corporate receipts

11/16/2010

Legislative Finance

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Attachment 9

Designated General Funds

- Designated General funds consist of fund sources that have been “designated” for a special purpose in statute
- Constitutional prohibition “trumps” statutory designation
- Therefore, Legislature has complete discretion on use of funding
- However, Legislature typically follows statutory “guidelines”

11/16/2010

Legislative Finance

13

Unrestricted General Funds

- Complete discretion how appropriated
- Typically referenced as a measure of state spending
- Utilized when calculating the Fiscal Surplus or Fiscal Gap
 - General Fund Revenue less General Fund Appropriations = Fiscal Surplus or (Gap)
- Approximately 90% of GF revenue is derived from Oil

11/16/2010

Legislative Finance

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Attachment 9

The Question?

- The levels of discretion play a large role in budgeting and financing programs
- What level is best?
- Example's:
 - PCE – statutory endowment
 - Revenue Sharing – rolling type plan
 - Pay as you go – most state programs

Questions?

Attachment 10

Endowment Structure

Example A: **\$400 Million Constitutional Fund**

Equivalent: Permanent Fund

Operation:

- \$400 deposited to capitalize constitutionally created fund
- Invested for long-term return
- Earnings (\$20 M/yr at assumed 5% ROI) accrue to account
- Excess earnings inflation-proof fund
- Account pays scholarships

STRENGTHS	WEAKNESSES
<ul style="list-style-type: none"> • Highest potential for long-term programmatic sustainability • Principal is safe • Inflation proof • Earnings provide predictable pay-out funding stream • Earnings: Very safe from “raiding” if const. protected 	<ul style="list-style-type: none"> • Necessity for large Initial investment • Necessity for constitutional amendment • Account is rare • Higher administrative cost? • Subject to market volatility • Questionable base for programmatic evolution
OPPORTUNITIES	THREATS
<ul style="list-style-type: none"> • High profile focal point for State investment • Highest likelihood of attracting outside donations 	<ul style="list-style-type: none"> • Pandora’s box and the Christmas tree effect • Earnings susceptible to “raiding” if not const. protected • Subject to market volatility

Attachment 11

Endowment Structure

Example B: **\$400 Million Statutory Fund (General Fund Sub-account)**

Equivalent: Power Cost Equalization Fund

Operation:

- \$400 deposited to capitalize fund
- Invested for long-term return
- Earnings (\$20 M/yr at assumed 5% ROI) accrue to account
- Excess earnings inflation-proof fund
- Account pays scholarships

STRENGTHS	WEAKNESSES
<ul style="list-style-type: none"> • High potential for long-term programmatic sustainability • Tried mechanism • Principal offers strongest programmatic insurance policy of unprotected fund-types • Earnings provide predictable pay-out funding stream 	<ul style="list-style-type: none"> • Necessity for large initial investment • Higher administrative cost? • Subject to market volatility • Questionable base for programmatic evolution
OPPORTUNITIES	THREATS
<ul style="list-style-type: none"> • High profile focal point for State investment • Strong base for programmatic evolution • Likelihood of attracting outside donations 	<ul style="list-style-type: none"> • Principal susceptible to “raiding” • Earnings susceptible to “raiding”

Attachment 12

“Rolling Fund” Structure

Example A: **Progressive Capitalization**

Equivalent: Community Revenue Sharing

Operation:

- Progressive fund capitalized up to \$160 million
- Interest bearing fund
- Principal and interest earnings pay for scholarships
- Yearly appropriations used to maintain value of fund corpus

STRENGTHS	WEAKNESSES
<ul style="list-style-type: none"> • Low capitalization hurdle • Tried mechanism • Lower administrative cost than endowment • Greater pay-out stream predictability than Default • Principal acts as fixed-term programmatic insurance policy 	<ul style="list-style-type: none"> • Susceptible to budget volatility • Susceptible to budgetary process • Less than predictable pay-out funding stream • Lower likelihood of attracting outside donations than Endowment
OPPORTUNITIES	THREATS
<ul style="list-style-type: none"> • Responsive to programmatic evolution • Some likelihood of attracting outside donations 	<ul style="list-style-type: none"> • Declining oil production/revenue • Declining federal spending • Increasing demand for services • Principal susceptible to “raiding” • Earnings susceptible to “raiding”

Attachment 13

“Rolling Fund” Structure

Example B: **Immediate Capitalization**

Equivalent: Community Revenue Sharing

Operation:

- Immediate fund capitalized up to \$200 million
- Interest bearing fund
- Principal and interest earnings pay for scholarships
- Yearly appropriations* used to maintain value of fund corpus
*Dividends, program receipts and other funds (AIDEA, AK Housing, ACPE) designated to Scholarship Fund

STRENGTHS	WEAKNESSES
<ul style="list-style-type: none"> • Moderate capitalization hurdle • Tried mechanism • Identified fund replenishment stream • Lower administrative cost than Endowment • Greater pay-out stream predictability than Default • Principal acts as fixed-term programmatic insurance policy 	<ul style="list-style-type: none"> • Necessity for substantial Initial investment • Susceptible to budget volatility • Susceptible to budgetary process • Less than predictable pay-out funding stream • Lower likelihood of attracting outside donations than Endowment
OPPORTUNITIES	THREATS
<ul style="list-style-type: none"> • Responsive to programmatic evolution • Some likelihood of attracting outside donations 	<ul style="list-style-type: none"> • Declining oil production/revenue • Declining federal spending • Increasing demand for services • Principal susceptible to “raiding” • Earnings susceptible to “raiding”

Attachment 14

Default Structure

Example: **Pay-As-You-Go**

Equivalent: Senate Bill 221

Operation: Yearly appropriation to support programmatic costs

STRENGTHS	WEAKNESSES
<ul style="list-style-type: none">• Most routine funding mechanism• No need for account creation• Lowest administrative cost• Yearly funding most directly matches yearly programmatic cost• Leaves greatest level of budgetary flexibility	<ul style="list-style-type: none">• Most susceptible to budget volatility• Most susceptible to budgetary process• Least predictable pay-out funding stream• Lowest likelihood of attracting outside donations
OPPORTUNITIES	THREATS
<ul style="list-style-type: none">• Most responsive to programmatic evolution	<ul style="list-style-type: none">• Declining oil production/revenue• Declining Federal spending• Increasing demand for services

Attachment 15

WORK DRAFT

WORK DRAFT

WORK DRAFT

27-LS0078AM
Mischel
9/7/10

HOUSE BILL NO.

IN THE LEGISLATURE OF THE STATE OF ALASKA
TWENTY-SEVENTH LEGISLATURE - FIRST SESSION

BY

Introduced:
Referred:

A BILL

FOR AN ACT ENTITLED

1 "An Act relating to Alaska scholarship awards; and establishing the Alaska scholarship
2 award income account and the Alaska scholarship fund."

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

4 * **Section 1.** AS 14.43.825(f) is repealed and reenacted to read:

5 (f) Payment of a scholarship is subject to appropriation and the availability of
6 funds for expenditure under AS 37.14.750. If insufficient funds are appropriated or
7 available in a fiscal year to pay all eligible scholarships, the commission may not
8 award a scholarship to a new applicant and the commission shall pay existing awards
9 on a pro rata basis for that fiscal year.

10 * **Sec. 2.** AS 14.43 is amended by adding a new section to read:

11 **Sec. 14.43.835. Alaska scholarship award income account.** The Alaska
12 scholarship award income account is created as an account in the general fund. Money
13 may be appropriated into the account from the Alaska scholarship fund under
14 AS 37.14.750 and from other sources. The commission may use the money in the

-1-

New Text Underlined [DELETED TEXT BRACKETED]

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Attachment 15

WORK DRAFT

WORK DRAFT

27-LS0078M

1 account to pay scholarships awarded to students under AS 14.43.810 - 14.43.849. The
2 amount determined under AS 37.14.750(c) each year and deposited into the account is
3 the maximum amount that may be used to pay scholarships for the immediately
4 succeeding fiscal year.

5 * **Sec. 3.** AS 37.14 is amended by adding a new section to read:

6 **Article 8A. Alaska Scholarship Fund.**

7 **Sec. 37.14.750. Alaska scholarship fund established.** (a) The Alaska
8 scholarship fund is established in the general fund for the purpose of making
9 scholarship payments to qualified postsecondary institutions and students under
10 AS 14.43.810 - 14.43.849. The fund consists of money appropriated to the fund.
11 Income earned on money in the fund and donations to the fund may be appropriated to
12 the Alaska scholarship income account established in AS 14.43.835. Money in the
13 fund does not lapse.

14 (b) Each fiscal year, the legislature may appropriate to the Alaska scholarship
15 fund an amount equal to 20 percent of the money received by the state during the
16 previous calendar year under AS 43.55.011(g). The amount may not exceed the
17 greater of

18 (1) \$40,000,000; or

19 (2) the amount that, when added to the fund balance on June 30 of the
20 previous fiscal year, equals \$160,000,000.

21 (c) The balance in the Alaska scholarship fund shall be determined on June 30
22 of each year. The department shall distribute one-third of that amount or \$40,000,000,
23 whichever is less, for deposit into the account established in AS 14.43.835. If the fund
24 balance is less than \$80,000,000 in a fiscal year, payments may be made only to
25 satisfy obligations from previous fiscal years.

26 (d) Notwithstanding the limitation in (b) of this section, the legislature may
27 appropriate any amount to the Alaska scholarship fund. Nothing in this section creates
28 a dedicated fund.

29 (e) In this section, unless the context requires otherwise, "fund" means the
30 Alaska scholarship fund established in (a) of this section.

31 * **Sec. 4.** The uncodified law of the State of Alaska is amended by adding a new section to

Attachment 15

WORK DRAFT

WORK DRAFT

27-LS0078M

1 read:

2 TRANSITION: ALASKA SCHOLARSHIP FUND BALANCE. Notwithstanding the
3 \$40,000,000 limit in AS 37.14.750(b), the following amounts shall be substituted for that
4 amount as follows for

5 (1) fiscal year 2012, \$15,000,000;

6 (2) fiscal year 2013, \$30,000,000.

-3-

New Text Underlined (DELETED TEXT BRACKETED)

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Attachment 16

WORK DRAFT

WORK DRAFT

WORK DRAFT

27-LS0078AB
Mischel
9/8/10

HOUSE BILL NO.

IN THE LEGISLATURE OF THE STATE OF ALASKA
TWENTY-SEVENTH LEGISLATURE - FIRST SESSION

BY

Introduced:
Referred:

A BILL

FOR AN ACT ENTITLED

1 "An Act relating to AlaskAdvantage education grant funding and to Alaska scholarship
2 funding; and establishing an account and fund for those purposes."

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

4 * **Section 1.** AS 14.43.410 is amended by adding a new subsection to read:

5 (c) Notwithstanding the provisions of this section, payment of a grant is
6 subject to appropriation and the availability of funds for expenditure under
7 AS 37.14.750. If insufficient funds are appropriated or available in a fiscal year to pay
8 all eligible grants, the commission may not award a grant to a new applicant, and the
9 commission shall pay existing awards on a pro rata basis for that fiscal year.

10 * **Sec. 2.** AS 14.43.825(f) is repealed and reenacted to read:

11 (f) Payment of a scholarship is subject to appropriation and the availability of
12 funds for expenditure under AS 37.14.750. If insufficient funds are appropriated or
13 available in a fiscal year to pay all eligible scholarships, the commission may not
14 award a scholarship to a new applicant, and the commission shall pay existing awards

-1-

New Text Underlined [DELETED TEXT BRACKETED]

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Attachment 16

WORK DRAFT

WORK DRAFT

27-LS0078B

1 on a pro rata basis for that fiscal year.

2 * **Sec. 3.** AS 14.43 is amended by adding a new section to read:

3 **Sec. 14.43.915. AlaskAdvantage education grant and Alaska scholarship**
4 **award income account.** The AlaskAdvantage education grant and Alaska scholarship
5 award income account is created as an account in the general fund. Money may be
6 appropriated into the account from the AlaskAdvantage education grant and Alaska
7 scholarship fund under AS 37.14.750 and from other sources. The commission may
8 use the money in the account to pay grants awarded under AS 14.43.400 - 14.43.420
9 and scholarships awarded to students under AS 14.43.810 - 14.43.849. The amount
10 determined under AS 37.14.750(c) each year and deposited into the account is the
11 maximum amount that may be used to pay scholarships for the immediately
12 succeeding fiscal year.

13 * **Sec. 4.** AS 37.14 is amended by adding a new section to read:

14 **Article 8A. AlaskAdvantage Education Grant and Alaska Scholarship Fund.**

15 **Sec. 37.14.750. AlaskAdvantage education grant and Alaska scholarship**
16 **fund established.** (a) The AlaskAdvantage education grant and Alaska scholarship
17 fund is established in the general fund for the purpose of making grant payments under
18 AS 14.43.400 - 14.43.420 and scholarship payments to qualified postsecondary
19 institutions and students under AS 14.43.810 - 14.43.849. The fund consists of money
20 appropriated to the fund. Income earned on money in the fund and donations to the
21 fund may be appropriated to the AlaskAdvantage education grant and Alaska
22 scholarship award income account established in AS 14.43.915. Money in the fund
23 does not lapse.

24 (b) Each fiscal year, the legislature may appropriate to the AlaskAdvantage
25 education grant and Alaska scholarship fund an amount equal to 20 percent of the
26 money received by the state during the previous calendar year under AS 43.55.011(g).

27 The amount may not exceed the greater of

28 (1) \$40,000,000; or

29 (2) the amount that, when added to the fund balance on June 30 of the
30 previous fiscal year, equals \$160,000,000.

31 (c) The balance in the AlaskAdvantage education grant and Alaska

-2-

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Attachment 16

WORK DRAFT

WORK DRAFT

27-LS0078\B

1 scholarship fund shall be determined on June 30 of each year. The department shall
2 distribute one-third of that amount or \$40,000,000, whichever is less, for deposit into
3 the account established in AS 14.43.915. If the fund balance is less than \$80,000,000
4 in a fiscal year, payments may be made only to satisfy obligations from previous fiscal
5 years.

6 (d) Notwithstanding the limitation in (b) of this section, the legislature may
7 appropriate any amount to the AlaskAdvantage education grant and Alaska
8 scholarship fund. Nothing in this section creates a dedicated fund.

9 (e) In this section, unless the context requires otherwise, "fund" means the
10 AlaskAdvantage education grant and Alaska scholarship fund established in (a) of this
11 section.

12 * **Sec. 5.** The uncodified law of the State of Alaska is amended by adding a new section to
13 read:

14 **TRANSITION: ALASKADVANTAGE EDUCATION GRANT AND ALASKA**
15 **SCHOLARSHIP FUND BALANCE.** Notwithstanding the \$40,000,000 limit in
16 AS 37.14.750(b), the following amounts shall be substituted for that amount as follows for

- 17 (1) fiscal year 2012, \$15,000,000;
18 (2) fiscal year 2013, \$30,000,000.

Attachment 17

SENATE EDUCATION COMMITTEE

CO-CHAIRMEN:

SENATOR KEVIN MEYER
SENATOR JOE THOMAS



MEMBERS:

SENATOR BETTYE DAVIS
SENATOR CHARLIE HUGGINS
SENATOR DONALD OLSON
SENATOR GARY STEVENS

Letter of Intent for Senate Bill 224

An Act establishing the Alaska Student Achievement Program...

It is the intent of the legislature to establish a scholarship program with the following goals:

- (1) improving preparedness of Alaska students for postsecondary education;
- (2) improving the postsecondary academic achievement;
- (3) improving the postsecondary graduation rates of students in the state;
- (4) providing a rigorous curriculum in all high schools in the state;
- (5) improving the quality of the educational programs offered by high schools in the state;
- (6) improving academic performance of students in grades kindergarten through 12 in the state;
- (7) increasing high school graduation rates in the state;
- (8) increasing the scores of high school students in the state on college entrance examinations;
- (9) expanding the pool of high school students in the state who pursue postsecondary opportunities;
- (10) increasing participation of Alaska high school graduates in Alaska postsecondary institutions; and
- (11) increasing job training opportunities in the state

Jomo Stewart, Committee Aide
(907) 465-6874

Murray Richmond, Committee Aide
(907) 465-6443

Senate_Education@legis.state.ak.us

Attachment 18

February 21, 2010 The Chronicle of Higher Education

Need That Class, Desperately? The Course Concierge Will See You Now



Jean Dixon, University of Nevada

Paul Neill, whom students think of as the "course concierge" at the U. of Nevada at Reno, can cut red tape that might be beyond advisers' reach.

By Eric Hoover

Paul Neill's title is director of the core curriculum at the University of Nevada at Reno, but students there know him as the "course concierge." He's the one they contact when they can't get into a class they need.

A few years ago, officials at the university decided that they had to do more to reduce the hassles of registering for courses. They imagined a kind of registration czar, someone who could communicate well with faculty members but who had the authority of an administrator. Mr. Neill, a faculty member who works in the provost's office, fit the bill.

Soon Nevada was promoting Mr. Neill as the course concierge, the man advisers and students could turn to when stuck. Each semester, he helps 50 to 60 students solve their scheduling problems, working one on one with those who need a particular course to graduate, or who have trouble getting into classes they must take in a sequence. Often he creates a spot in a class that's full, or steers students to suitable alternatives.

"In the past, it was often left up to the student and the professor to see who could get in where," Mr. Neill says. "It was very informal."

Attachment 18

Even in times of plenty, students often learn a tough lesson when they register for courses: You can't always get what you want. In this era of budget cuts, however, students on some campuses have scrambled to get not only the courses they would like but also those they need for their majors and to satisfy core requirements.

As colleges pack more students into fewer courses, the scheduling puzzle has become more challenging for administrators, instructors, and students alike. Institutions are using a variety of strategies to alleviate the course crunch, and often that begins with improving the registration process.

Nevada's president, Milton D. Glick, proposed the course-concierge program as a way to improve timely progression toward degrees at the university, which has about 13,000 undergraduates. Over the years he has learned that even small scheduling snags can discourage students, delay their progress, and make them more likely to transfer or drop out.

After he arrived, in 2006, Mr. Glick developed a plan to improve Nevada's retention and graduation rates. He pledged publicly that students would get the courses they needed to graduate on time. To that end, his course-concierge program provides a backstop for the university's academic advisers.

Mr. Neill is not a replacement for advisers, who continue to meet with students and help them select courses. But they sometimes encounter dilemmas that they can't handle on their own. "They don't always have the ability to cut through red tape, to get through to the department, to get something done," Mr. Glick says. "Paul can get a phone call through."

'A Relief Valve'

When Natica Rudavsky contacted Mr. Neill this winter, she was frantic. Ms. Rudavsky, a transfer student who has a bachelor's degree from another university, wanted to pursue a second degree, in nutrition, at Nevada, but she was confused about which core requirements would apply to her. Would the university waive that required mathematics course?

By the time she and her adviser had sorted that out, it was late in the registration cycle, and all the courses she needed were full. Mr. Neill evaluated her record, then discussed her options with her. Ultimately, he found Ms. Rudavsky a spot in three of the four courses she sought. "If he hadn't helped," Ms. Rudavsky says, "I probably would have just waited until the next semester to enroll."

Attachment 18

The course concierge doesn't cater to whims. A student who just wants to avoid that 8 a.m. class would not get help from Mr. Neill. The same might go for a senior who had never bothered to register for a required course that he had every opportunity to take.

The service does cater to those who truly have a need, or are simply stuck or confused. "We've taken some of the burden off the shoulders of advisers," he says. "It's a relief valve."

The course concierge has also helped the university plan more effectively during a difficult time. For the current fiscal year, the state cut the university's budget by \$33-million, or 15 percent. Last semester, Nevada offered 96 fewer course sections than it did in the fall of 2008, a 6-percent reduction.

Recently, Mr. Neill's work with students helped him identify scheduling conflicts that made it difficult for them to register for the right courses. For instance, freshmen and sophomores taking biology or chemistry courses are supposed to enroll simultaneously in Math 127. Yet Mr. Neill realized that that math lecture overlapped with several of the laboratory sections.

He discussed the issue with the three departments, which adjusted their schedules accordingly. "The departments probably would have become aware of this," he says, "but the concierge service helped them understand it quickly."

Better Communication

Elsewhere, administrators have looked for ways to make small but meaningful changes in the registration process. This fall the University of California at Santa Barbara, which has seen substantial budget cuts and an enrollment surge, created an online waiting list for courses. The system formalized the process of determining who gets a spot, allowing advisers to better evaluate students' needs and communicate with them more effectively.

"It was a huge help," says Mary Nisbet, acting dean of undergraduate education. "Now faculty aren't getting hundreds of e-mails, and students know there is somewhere to go where advisers will get back to them."

This past fall, the university reduced the number of credits students could sign up for during the second round of registration. As a result, juniors and seniors, who have priority, can snag a total of four classes, instead of five, at that time.

Attachment 18

In the past, many students eventually dropped their fifth course anyway. The new policy has encouraged older students to focus on getting the courses they really need, and the change recently freed up at least 1,500 class spots for other students, Ms. Nisbet says.

For the first time, the university is offering schedule-planning workshops, in which students learn how to prioritize. "We're trying to help students weather a storm," she says.

Many institutions have turned to sophisticated data analysis to better anticipate course demand. At the University of California at Berkeley, Catherine P. Koshland helps lead a task force that will determine which courses students will need—and how many—in the coming years.

To do that, Ms. Koshland and her colleagues have begun to examine a decade's worth of enrollment data, which help them predict how many freshmen will need to take a specific math sequence, for instance, or how many sections of pre-med physics courses the university will need.

"We can bring some rationality to the offerings, rather than having departments guesstimate," says Ms. Koshland, vice provost for teaching, learning, academic planning, and facilities. "We're bringing more and more discipline to something that could grow organically before, when there was elasticity in the system. There's no elasticity now."

(Head Count explores the changing enrollment landscape. Please send ideas to eric.hoover@chronicle.com)

SB

23

(FILE 1)



SENATOR KIM ELTON

MEMORANDUM

February 4, 2009

To: Senator Joe Paskvan, Chair
Senate Labor & Commerce Committee

From: Kim Elton

Re: Sectional Analysis, SB 23

Sec. 1 Updates the definition of a retirement “plan” in the teachers’ retirement system to remove references to the DC plan repealed by the bill. It also updates the definition of “system.”

Sec. 2 Replaces language limiting the DC plan to employees hired after July 1, 2006 with language describing the defined benefit teachers’ retirement system.

Secs. 3-5 Adjust references for the purpose of applying existing law to teachers who elect to remain in the former DC plan, repealed by the bill.

Secs. 6 and 7 Allow the Alaska Retirement Management Board, rather than the administrator, to adjust pension payments for inflation when the financial condition of the TRS trust fund permits, by removing the 105 percent minimum funding ratio.

Secs. 8-24 Adjust references for the purpose of applying existing law to teachers and public employees who elect to remain in the former DC plan, repealed by the bill.

Sec. 12 Adjusts a reference to ensure the Alaska Retirement Management Board continues oversight of the health reimbursement arrangement portion of the former DC plan, repealed by the bill.

Secs. 13 through 24 Adjust references for the purpose of applying existing law to teachers and public employees who elect to remain in the former DC plan, repealed by the bill.

Sec. 25 Updates the definition of a retirement “plan” in the teachers’ retirement system to remove references to the DC plan repealed by the bill.

Sec. 26 Updates the definition of a retirement “system” in the public employees’ retirement system to remove references to the DC plan repealed by the bill.

Sec. 27 Replaces language limiting the DC plan to employees hired after July 1, 2006 with language describing the defined benefit public employees’ retirement system.

Secs. 28 and 29 Adjust references for the purpose of applying existing law to public employees who elect to remain in the former DC plan, repealed by the bill.

Sec. 30 Allows the Alaska Retirement Management Board, rather than the administrator, to adjust pension payments for inflation when the financial condition of the PERS trust fund permits, by removing the 105 percent minimum funding ratio.

Sec. 31 Removes language, made obsolete by the repeals in Section 33 of the bill, regarding the return of previously terminated employers to PERS.

Sec. 32 Adjusts a reference for the purpose of applying existing law to public employees who elect to remain in the former DC plan, repealed by the bill.

Sec. 33 Repeals the defined contribution retirement systems for both teachers and other public employees.

Sec. 34 Gives employees hired into the defined contribution plans who have not refunded out of those plans a 90-day period from the effective date of the bill (or until September 1, 2009, whichever is later) to irrevocably convert into PERS tier III or TRS tier II, as appropriate. It also gives them the opportunity to transfer their contributions from the DC plan to the DB plan if they make the switch.

Sec. 35 Sets for the procedure for the conversion election in Sec. 34 and allows the Alaska Retirement Management Board to adopt regulations related to the conversion. The choice to convert is irrevocable, and certain information must be provided to the employee. Employees who transfer receive credited service in the defined benefit plan equal to the lesser of the employee’s actual service or the actuarially calculated value of the employer and employee money transferred from the defined contribution account.

Sec. 36 Allows the Commissioner of Administration to adopt regulations to implement and make specific the bill’s provisions.

Sec. 37 Instructs the Revisor of Statutes to submit a bill via the Legislative Council to make technical or clarifying changes, if needed.

Sec. 38 is an immediate effective date for sections 35 and 36 of the bill.

Dear Governor Palin:

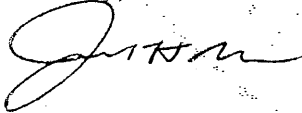
The mission of the American Fisheries Society (AFS) is to improve the conservation and sustainability of fishery resources and aquatic ecosystems by advancing fisheries and aquatic science and promoting the development of fisheries professionals. The fisheries professionals within the Alaska Chapter of AFS strive to meet this objective through a sustained effort in the advancement and development of Alaska's aquatic resources. The Past Presidents Committee, comprised of individuals representing the Chapter's institutional knowledge and experience, is deeply concerned about trends in recruitment and retention of the state employees responsible for the conservation and sustainable management of the State's fisheries resources.

In 2006, the retirement and benefits package for state employees was changed from defined benefits to defined contributions. This change will create a very mobile work force that is able to switch employers and take their retirement package with them. Incentives need to be in place to retain good employees or they will seek better pay and benefits with the private sector or other government agencies. In the absence of salary and retirement packages that at least equal those offered by other entities, the recruitment and retention of qualified individuals into state positions will become increasingly difficult.

As past presidents of the AFS Alaska Chapter, we believe the future of Alaska's fisheries is directly linked to the quality and experience of aquatic resource professionals in state employment. Recent and anticipated upcoming retirements by many long-term employees, combined with the lack of retention and recruitment of newer employees, will leave few individuals with the experience necessary to effectively manage, research, and develop Alaska's aquatic resources. We feel that competition in the job market will become more intense in the future, especially when a gas pipeline is constructed. Therefore, we urge you to work with the legislature to re-examine the long-term impacts of current salary schedules and recent changes to the retirement and benefits package on employee retention.

Thank you for your consideration of this issue that has such broad effects on a part of the Alaska economy that employs so many people in our state.

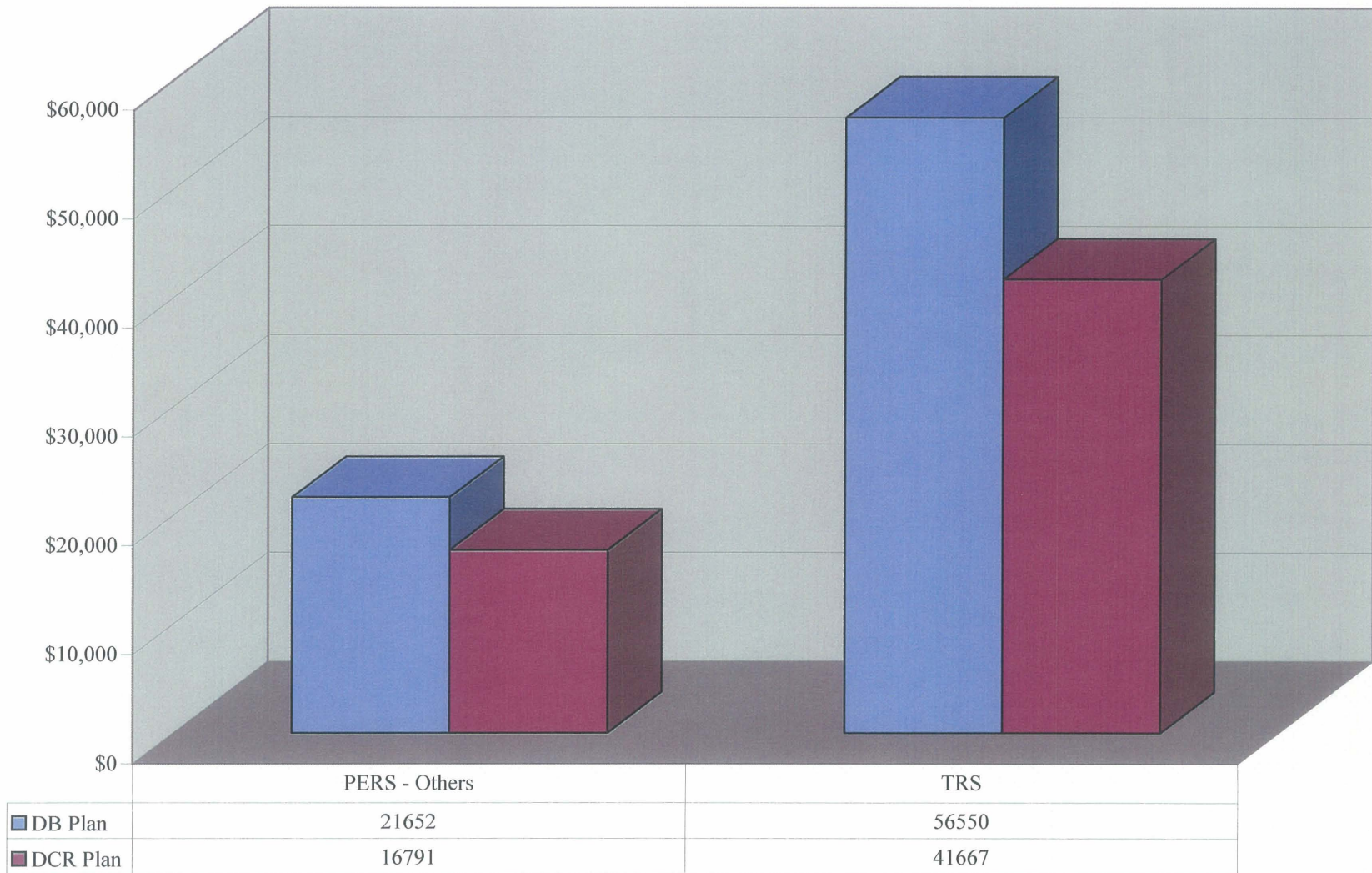
Sincerely,



Jamal Moss, Scott Maclean, Hal Geiger, Tim Joyce, Carol Kerkvleif, Bill Bectol, Cindy Hartmann, Alex Wertheimer, Tom Kron, and Bill Wilson

cc- all current Alaska Legislators

**Value of Employer-Paid Benefits
(31-year old new employee)**



Based on data provided by Buck Consultants, letter dated May 4, 2006

Assumes a married member with starting salary of \$35.5/year.



SENATOR KIM ELTON

Memorandum

TO: Sens. Hoffman and Stedman, co-chairs, and Finance Committee members

FROM: Sen. Kim Elton

RE: Defined Benefit/Defined Contribution

DATE: March 30, 2007

Attached are slightly reformatted charts codifying data provided by Buck Consultants in their letter dated March 19, 2007. The Buck letter responds to requests by the committee to disaggregate by tiers data that previously was dumped into only two buckets for comparison purposes—a defined benefit bucket and a defined contribution bucket. Now we have several buckets of data—four PERS buckets (tiers 1-4) and three TRS buckets.

The normal cost charts for PERS and TRS are easy-to-read comparisons of PERS pension and medical costs by tier and TRS pension and medical costs by tier. The third chart, the accrued liability chart, puts dollar amounts to liabilities by tier.

Here are some demonstrable basics revealed by the Buck data:

- the PERS tier 3 DB employees are just slightly more expensive than the new DC employees;
- the new TRS DC employees are very slightly more expensive than the TRS tier 2 DB employees;
- the very slight cost advantage of a PERS tier 4 over a tier 3 is erased when tier 4 employees leave early and take employer dollars that, if left in the system, would help meet pension benefit obligations in the out years; so
- the DB PERS tier 3 and the DB TRS tier 2 fundamentally fixed the problems the governor claimed had to be fixed by his new DC plan.

There also are some other DB/DC inferences that can be drawn:

- recruitment for quality public employees is made more difficult when Alaska is a defined contribution pension system (without even the backstop of the defined Social Security benefit) because professionals can work with other public employers that are just as competitive on wages and almost all of whom provide a defined benefit pension; and
- retention is made more difficult with the portability provisions of the defined contribution because relatively short-term employees can take their contributions as-well-as employer contributions out of the retirement systems and go to

ALASKA SENATE

STATE CAPITOL • JUNEAU, ALASKA 99801-1182 • (907) 465-4947 • FAX (907) 465-2108
SENATOR_KIM_ELTON@LEGIS.STATE.AK.US

another public employer that provides a defined benefit (any federal employer, or any other state, or almost all municipalities or school districts outside Alaska). As we know, a high percentage of teachers and public employees leave before five years and now new DC employees have a special financial inducement to leave—they can cut and run and take the employer dollars, too.

These inferences are now backed with anecdotal Alaska evidence, even after less than a year's experience with tier 4. Further, the anecdotal Alaska evidence mimics the real-life experience of the two states that actually moved to a defined contribution but later back-tracked because of recruitment and retention problems.

Given the instructive Buck numbers that finally compare the immediately previous DB plans to the replacement DC plan and given, too, the cost-sharing bills that will spread the past service costs to employers regardless of tiers, we need to review what we wrought with SB141.

We must not assume our only options now are passing a DC 'fix-it' bill and passing a cost sharing bill that spreads the pain of past service costs. At a minimum we must also decide whether to give new employees a choice of tier 3 or DC in the PERS system or tier 2 and DC in the TRS system. If the cost differences are a wash, why limit the ability of employers to recruit and retain, and limit new employees to a risky defined contribution plan?

Normal Cost

Employer Normal Cost Rate	PERS Pension	PERS Medical	PERS Total	# of Active & Retired ¹
Tier 1 (DB)	9.15%	10.46%	19.61%	26,263
Tier 2 (DB)	5.33%	10.41%	15.74%	10,999
Tier 3 (DB)	1.55%	9.28%	10.83%	18,719
Tier 4 (DC)	5.67%	3.99%	9.66%	2,214

¹ as of October, 2006

Employer Normal Cost Rate	TRS Pension	TRS Medical	TRS Total	# of Active & Retired ²
Tier 1 (DB)	7.18%	8.02%	15.20%	11,872
Tier 2 (DB)	2.16%	8.96%	11.12%	7,635
Tier 3 (DC)	7.56%	3.99%	11.55%	754

² as of October, 2006

Accrued Liability³

Accrued Liability (DB)	PERS Pension	PERS Medical	PERS Total	TRS Pension	TRS Medical	TRS Total
Tier 1	\$5,628,778	\$4,036,751	\$9,665,530	\$3,925,023	\$1,816,223	\$5,741,247
Tier 2	1,123,559	1,334,674	2,458,233	409,562	347,748	757,309
Tier 3	334,854	386,224	721,078	N/A	N/A	N/A
Total	\$7,087,191	\$5,757,650	\$12,844,841	\$4,334,585	\$2,163,971	\$6,498,556
Assets ^o			\$8,442,919			\$3,958,939
Accrued Liability			\$4,401,922			\$2,539,617

³ per Buck Consultants letter, March 2007

^oPERS DB net assets as of 6/30/2008 were \$10,726,913,000.

TRS DB net assets as of 6/30/2008 were \$4,804,371,000.



Do I need to take Leave to Attend Seminars?

State of Alaska > Departments > Administration > Retirement and Benefits > Do I need to take Leave to Attend Seminars?

To All Employees,

Questions have arisen about whether attendance at Retirement and Benefits seminars constitute work time. This memorandum is to clarify this matter.

If an employee attends a Retirement & Benefits sponsored seminar during his/her regularly scheduled work day, the time is counted as work time. Approval to be away from the work site must be secured from the supervisor in advance. If the seminar is offered outside the employee's regularly scheduled work day it will not be counted as work time and is not compensable time.

If there is any question about whether or not a State sponsored event is work time, please contact your Human Resource Service Center for assistance.

Nicki Neal
Director, Division of Personnel
Department of Administration

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INVESTMENT RETURNS: DEFINED BENEFIT VS. 401(k) PLANS

BY ALICIA H. MUNNELL, MAURICIO SOTO, JERILYN LIBBY, AND JOHN PRINZIVALLI*

Introduction

Pension coverage in the private sector has shifted from defined benefit plans where professionals manage the money to 401(k) plans where participants invest their own accounts. The supposition is that individuals are not very good at investing their own money. The question is whether the supposition is borne out by the facts. That is, are returns on 401(k) plans markedly lower than those on traditional defined benefit plans?

This *brief* first reports rates of return on defined benefit and 401(k) plans over the period 1988-2004. The second section then looks at the holdings of the two types of plans to see whether the differences in returns can be explained by a more risky portfolio. The third section speculates about the role fees play in the results. The fourth section explores the implications of the findings for 401(k) participants. The final section reports on Individual Retirement Accounts (IRAs), because the assets in these accounts now exceed holdings in either defined benefit or

defined contribution plans, and most of the money is rolled over from employer-sponsored plans.

The bottom line is that over the period 1988-2004 defined benefit plans outperformed 401(k) plans by one percentage point. This outcome occurred despite the fact that 401(k) plans held a higher portion of their assets in equities during the bull market of the 1990s. Part of the explanation may rest with higher fees, which are deducted before returns are reported to participants. But the one percentage point shortfall understates the investment problem in 401(k) plans, since an aggregate number does not reflect the fact that more than half of participants in 401(k) plans do not follow the prudent investment strategy of diversifying their holdings. Finally, the available data suggest that IRAs produce even lower returns than 401(k) plans, which, if true, implies trouble ahead given the massive amount of money that is being rolled over into these accounts.

* Alicia H. Munnell is the Director of the Center for Retirement Research at Boston College (CRR) and the Peter F. Drucker Professor in Management Sciences at Boston College's Carroll School of Management. Mauricio Soto is a senior research associate, Jerilyn Libby is a research associate, and John Prinzivalli is a student research assistant at the CRR. The authors would like to thank Sylvester Schieber and Brendan McFarland for providing access to Watson Wyatt's previous research and Peter Diamond and Francis Vitagliano for helpful comments.

Rates of Return in Defined Benefit and 401(k) Plans

Financial assets in private sector defined benefit and defined contribution plans (including IRAs) totaled \$8.5 trillion at the end of 2005 (see Table 1). At that time, defined benefit assets accounted for only 23 percent of the total, while self-directed defined contribution plans and IRAs made up the rest. Thus, the question of how individuals fare when investing their own retirement funds is an important one.

TABLE 1. PRIVATE SECTOR RETIREMENT ASSETS, YEAR END 2005

Type of plan	Billions of dollars	Percent of total
Defined benefit	\$1,916.5	22.7 %
Defined contribution	2,868.7	33.9
IRAs	3,667.0	43.4
Total	8,452.2	100.0

Source: U.S. Board of Governors of the Federal Reserve System (2006).

The first step in assessing the performance is to compare median annual rates of return for defined benefit and 401(k) plans. The analysis focuses on companies that sponsor both types of plans to minimize the effect of company or participant characteristics on the results.¹ The formula for calculating rate of return is one commonly used by actuaries.² It relates the change in assets ($A_t - A_{t-1}$), netting out the impact of benefit payments from the plan (B) and contributions to the plan (C), to initial assets (A_{t-1}) plus half of net inflows ($C - B$):

$$\text{Rate of return} = \frac{(A_t - A_{t-1}) + B - C}{(A_{t-1}) + \frac{1}{2}(C - B)}$$

The Department of Labor's Form 5500 filings provide data on assets, contributions, and benefits for each plan over the period 1988-2004.³

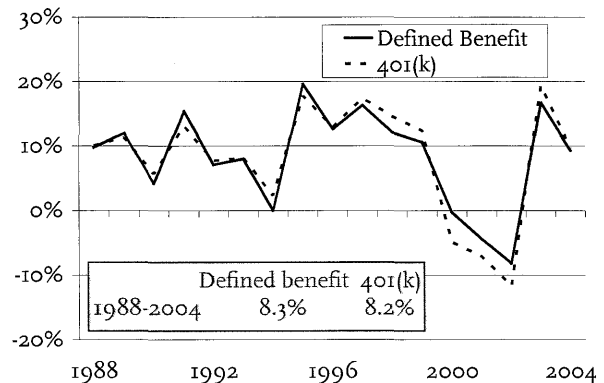
Returns, even median returns, can be calculated in a number of ways. The analysis presented below starts with the simplest approach, and one used in earlier studies, that arrays the plans and reports the return for the plan at the 50th percentile. In terms of the example shown below, the median rate of return would be 5 percent. One obvious question is whether comparing median rates of return is the right exercise, since three-quarters of the total assets in the example are in Plan A earning 10 percent. An alternative measure would be one that weighted returns by plan assets, and then identified the median. Such an approach would yield a return of 10 percent in this example. In our view, this is the preferred approach, although both results are reported below.

EXAMPLE: UNWEIGHTED VERSUS WEIGHTED MEDIANS

Plan	Assets	Rate of return
Plan A	\$75	10 %
Plan B	20	5
Plan C	5	2

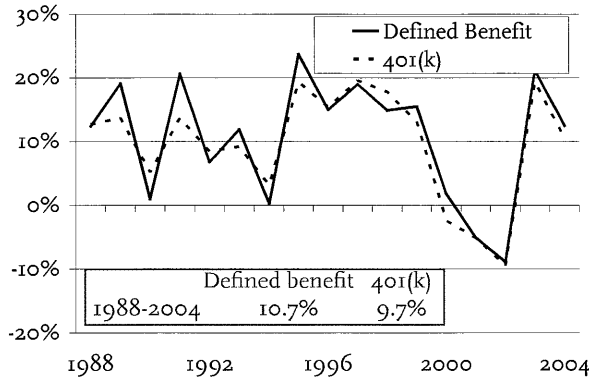
Figure 1 shows the simple medians over the period 1988-2004.⁴ During the period, the average of this measure suggests that the performance of defined benefit and 401(k) plans is virtually identical — 8.3 percent versus 8.2 percent.⁵

FIGURE 1. UNWEIGHTED MEDIAN RATES OF RETURN FOR DEFINED BENEFIT AND 401(k) PLANS, 1988-2004



Source: Authors' calculations from U.S. Department of Labor (1990-2006).

FIGURE 2. WEIGHTED MEDIAN RATES OF RETURN FOR DEFINED BENEFIT AND 401(K) PLANS, 1988-2004



Source: Authors' calculations from U.S. Department of Labor (1990-2006).

Figure 2 recalculates rates of return weighting returns by assets in the plan. Two factors change. First, the returns are higher. Second, defined benefit plans appear to have outperformed 401(k) plans by one percentage point (10.7 percent versus 9.7 percent).

The higher return reflects the fact that larger plans have historically performed better than smaller ones (see Table 2). The usual explanation is that large plans can hire better managers and spread fees over a larger base. Size matters much less for 401(k) plans, because the outcome reflects a myriad of individual investment decisions.

TABLE 2. MEDIAN RATES OF RETURN BY ASSET QUINTILE FOR DEFINED BENEFIT AND 401(K) PLANS, 1988-2004

Asset quintile	Defined benefit	401(k)
Largest 20 percent	10.1 %	8.8 %
Second	8.9	8.1
Third	8.2	7.8
Fourth	7.4	7.6
Smallest 20 percent	5.6	6.6

Source: Authors' calculations from U.S. Department of Labor (1990-2006).

The Impact of Portfolio Allocation

One question is the extent to which portfolio differences can explain differences in rates of return. Based on historical performance, stocks have a high yield and big fluctuations in annual rates of return; corporate bonds have a lower yield and much less variation; Treasury bills are the most predictable investment but provide the lowest return (see Table 3).

TABLE 3. ANNUAL TOTAL RETURNS ON VARIOUS FINANCIAL INSTRUMENTS, 1926-2005

Financial instrument	Rate of return	Standard deviation
Stocks	10.4 %	20.2 %
Long-term corporate bonds	5.9	8.5
Intermediate government bonds	5.3	5.7
U.S. Treasury bills	3.7	3.1
Inflation	3.0	4.3

Source: Ibbotson Associates (2006). Based on copyrighted works by Ibbotson and Sinquefeld. All rights reserved. Used with permission.

Table 4 shows a breakdown by type of investment for both defined benefit and defined contribution plans.⁶ Defined benefit plans appear to hold about 59 percent of assets in equities, compared to 35 percent for defined contribution plans.⁷ But that is not the end of the story because mutual funds also reflect equity holdings, and mutual funds are a very important component of the assets of defined contribution plans. In 2005, roughly 78 percent of the mutual fund assets in 401(k) plans were equities.⁸ Applying that percentage to both the defined benefit and defined contribution mutual fund numbers yields total equity holdings of 67 percent in defined benefit plans and 65 percent in defined contribution plans.

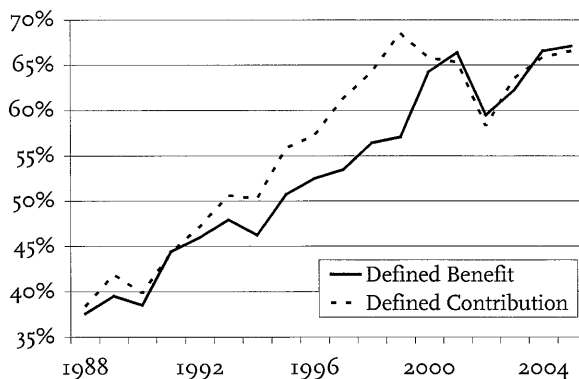
TABLE 4. PERCENTAGE DISTRIBUTION OF ASSETS IN PRIVATE SECTOR DEFINED BENEFIT AND DEFINED CONTRIBUTION PLANS, YEAR END 2005

Financial instrument	Defined benefit	Defined contribution
Equities	58.8%	35.2%
Mutual funds	10.6	38.5
Bonds	21.9	6.7
Cash	3.1	4.5
GICs	3.6	8.7
Other	2.0	6.4
Total	100.0	100.0

Source: U.S. Board of Governors of the Federal Reserve System (2006).

Figure 3 shows the percentage of the portfolios in equities for defined benefit and defined contribution plans over the period 1988-2005, where a portion of mutual funds are included in equities as described above. The higher share in equities for defined contribution plans in the late 1990s allowed 401(k) plans to outperform defined benefit plans. The reliance on equities also meant that 401(k) participants were hurt more when the stock market collapsed in 2000, and then did better when the stock market recovered.

FIGURE 3. EQUITIES AS A PERCENT OF TOTAL PORTFOLIO, DEFINED BENEFIT AND DEFINED CONTRIBUTION PLANS, 1988-2005



Sources: Authors' calculations from U.S. Board of Governors of the Federal Reserve System (2006); Investment Company Institute (2005); and Investment Company Institute (2006b).

One interesting aspect of Figure 3 is not the difference between the defined benefit and defined contribution portfolios, but the fact that both professional managers and individual 401(k) participants dramatically increased their holdings of equities over the period. If defined benefit portfolios were optimally balanced in the early 1990s with about 40 percent in equities, what would make 65 percent optimal by the end of the period? In the case of defined benefit plans, an aging beneficiary population would argue, if anything, for less equity investment. Some potential explanations include: 1) professional managers, like individual investors, forgot to re-balance; 2) professional managers, like individual investors, got swept up in the euphoria of the boom and purposely increased their holdings of stocks; 3) sponsors of fully funded defined benefit plans felt like they could gamble with their "surplus" funds; or 4) defined benefit managers wanted to hold the market portfolio and the boom caused equities to increase as a share of the total market. Regardless of the explanation, defined benefit and defined contribution plans both held 40 percent of their portfolios in equities in 1990 and increased their holdings to 65 percent by 2000. The difference is that during most of that period, individual 401(k) investors had higher equity holdings.

The Role of Fees

Another possible explanation for the lower return in defined contribution plans is investment fees, which typically account for 75 to 90 percent of total expenses associated with managing 401(k) plans.⁹ These fees compensate providers of, say, mutual funds for selecting the stocks and undertaking the research that leads to buy and sell decisions. These fees are usually assessed as a percentage of invested assets, and are paid by the employee in that they are deducted directly from investment returns.¹⁰

Mutual funds are the major investment vehicle for 401(k) participants, and Table 5 reports the fees for alternative investments. The fees vary substantially depending on whether the investments are actively managed or follow an index. For example, an actively managed Global Fund costs 1.72 percent of assets annually compared to 0.59 percent for an S&P Index Fund. Given these charges, it is probably reasonable to assume that fees reduce the gross return on 401(k) plans by about one percentage point.

Of course, defined benefit plans also involve some expenses but these are small compared to those associated with 401(k) plans.¹¹

TABLE 5. MUTUAL FUND FEES AS A PERCENT OF ASSETS, JULY 31, 2006

Category	Fee
Global Fund	1.72%
Equity Income Fund	1.33
Balanced Fund	1.22
Intermediate Bond Fund	0.92
S&P Index Fund	0.59
Institutional Money Market Fund	0.45

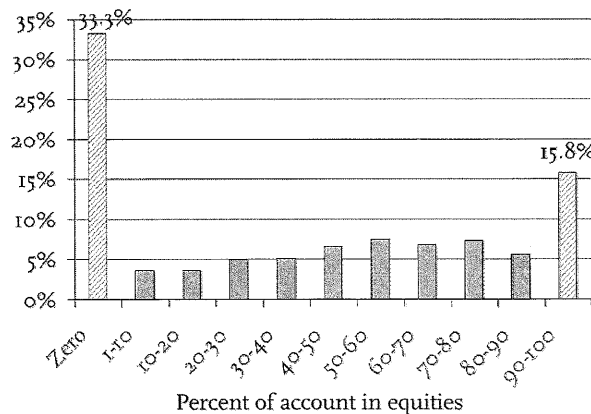
Source: Lipper (2006).

The Implications for Individual 401(k) Participants

So far the discussion has focused only on totals and averages, which tell us little about how individuals might invest. After all, if a plan has 100 participants and half invest all their assets in stocks and the other half all their assets in bonds, the aggregate data suggest that participants are well diversified when in fact they are not. Therefore, it is useful to look at investment data from particular 401(k) plans to see whether the individual participants have balanced portfolios or whether the balance simply reflects offsetting behavior.

As shown in Figure 4, detailed data on the asset allocation of individual participants show that nearly half of all participants have either none of their ac-

FIGURE 4. EQUITIES AS A PERCENT OF 401(k) PARTICIPANT ACCOUNT BALANCES BY PERCENT OF PARTICIPANTS, 2005



Source: Holden and VanDerhei (2006).

count in equities or virtually all of their account in equities. So even though the aggregate data suggest that participants make sensible investment choices on average, the individual data reveal that a majority of participants are not diversified at all. Given their choices, most participants face the risk of ending up with inadequate retirement income or exposing themselves to large swings in the value of their assets.¹² Thus, the one percentage point difference in returns between defined benefit and 401(k) plans understates the poor investment decisions made by individuals.

TABLE 6. ASSET HOLDINGS AND IRAS BY INSTITUTION, YEAR END 2005

Institution	Percent of total
Mutual funds	39.0 %
Life insurance companies	11.1
Money market mutual funds	4.4
Commercial banking	4.6
Saving institutions	1.5
Credit unions	1.3
Other self-directed accounts	38.0
Total	100.0
Memorandum: total assets (billions)	\$3,667.0

Source: U.S. Board of Governors of the Federal Reserve System (2006).

The Inclusion of IRAs

It has become impossible to ignore the role of IRAs. As shown earlier in Table 1, IRAs now hold more money than either defined benefit or defined contribution plans. And even though most IRAs are not sponsored by employers, the Investment Company Institute (2006b), the national association for mutual fund companies, reported that 94 percent of the money flowing into traditional IRAs was rolled over from employer-sponsored plans in the period 1997-2003.¹³ Although detailed information is not available, it is probably reasonable to assume that most of the rollovers come from defined contribution plans — although lump-sum payments are becoming increasingly common in defined benefit plans.

Only limited information is available on the asset allocation in IRAs. The Flow of Funds data show only the type of institution holding the account, as opposed to the type of asset in the account (see Table 6). About 73 percent of the mutual fund assets — the

largest component — are in stock.¹⁴ But no information is available on the composition of IRA assets held by other institutions, which hold the majority of the assets.

The Investment Company Institute (2006a) provides data on beginning-year assets, year-end assets, contributions, rollovers, and withdrawals for traditional IRAs that make it possible to calculate the aggregate average return for the period 1998-2003. Table 7 summarizes these results and compares them to returns earned on defined benefit and 401(k) plans over the same period. If estimates of the flows into and out of IRAs are correct, the rate of return numbers suggest that IRA investments produced significantly lower returns than either defined benefit or 401(k) plans during the six-year period.¹⁵ More important than the precise numbers, however, is the message that the performance of IRAs will have a significant impact on the retirement security of people in the future.

TABLE 7. RATE OF RETURN FOR IRAs, DEFINED BENEFIT PLANS AND 401(k)s, 1998-2003

Year	IRA	Defined benefit	401(k)
1998	13.6 %	14.9 %	17.8 %
1999	15.7	15.5	13.1
2000	-6.0	1.8	-2.4
2001	-4.6	-5.1	-5.1
2002	-8.1	-8.9	-9.5
2003	12.1	21.2	19.4
1998-2003	3.8	6.6	5.6

Source: Authors' estimates based on Investment Company Institute (2006a).

Conclusion

Three main conclusions emerge from this review. First, defined benefit plans outperformed 401(k) plans over the period 1988-2004. This conclusion is most evident using the weighted median. A higher equity allocation most likely led to higher 401(k) returns during the 1990s, while fees inevitably reduced returns. These two effects may well have balanced each other out, leaving a one percentage point shortfall due to poor timing and other investment mistakes.

Second, lower returns are only one component of the investment problems facing 401(k) investors. The other is that despite a reasonable mix for 401(k) assets in the aggregate, nearly half of 401(k) participants are either nearly fully invested in stocks or hold no stocks at all. That is, nearly 50 percent of participants are not diversified in their retirement accounts. The combination of the lack of diversification and the lower returns suggests that introducing balanced portfolios as a default, which would remove the individual from the decision making, would significantly improve the performance of 401(k) plans.

Finally, IRAs are now bigger than either defined benefit or defined contribution plans, and their performance is going to have a major impact on retirement security in the future. Preliminary data suggest that IRAs underperform employer-sponsored plans. IRAs are too big and important a form of retirement saving to not know what is going on with these accounts. Some mechanism is needed to identify the asset allocations in these accounts as well as document the inflows and outflows. Only by including IRAs will it be possible to understand fully how well people are investing for retirement.

Endnotes

- 1 This formulation follows Watson Wyatt (2002 and 2003). Calculations for the entire universe of plans showed very similar results.
- 2 Including one half of contributions less benefits assumes that net inflows occur at an even rate over the year so that on average half the annual net inflows are available for investment. This assumption is necessary because the Form 5500 lacks detailed information on the timing of benefits and contributions over the year.
- 3 See Buessing and Soto (2006) for a detailed description of the Form 5500 data.
- 4 The median refers to the across-firm rates of return per year for defined benefit and defined contribution plans. The average returns shown are the arithmetic means of the median rates of return over the period 1988-2004. The geometric means do not differ widely from the arithmetic means calculated for the unweighted and weighted median rates of return. Appendix Table A1 shows the unweighted and weighted median rates of return as well as the arithmetic and geometric means.
- 5 For the 1990-2002 period, the results are similar to results from Watson Wyatt (2004) with defined benefit plans outperforming 401(k) plans. The difference in defined benefit and 401(k) returns is 0.35 percent while Watson Wyatt showed a difference of 0.56 percent for this period. The improved performance of 401(k)s over the 1988-2004 period comes simply from adding four more years of data to what was a very close outcome.
- 6 Separate data on 401(k) plans are not available on a comparable basis. But in 2004, 401(k) assets accounted for 88 percent of total private sector defined contribution assets for plans sponsored by employers with 100 or more employees. See Munnell and Perun (2006).
- 7 Since most 401(k) participants invest through mutual funds, the high number for "Equities" for defined contribution plans (that is, direct equity holdings as opposed to equities held through mutual funds) in Table 4 is surprising. The explanation is that "Equities" include pools of stocks that companies set up themselves for their 401(k) plans; only mutual funds bought off the shelf are included in the mutual fund line. The other large category of direct equity holdings is employer stock. The final category of direct equity investment arises from a relatively small percentage of 401(k) participants who invest directly through brokerage accounts.
- 8 Investment Company Institute (2006a).
- 9 Munnell and Sundén (2004).
- 10 Fees are generally not explicitly reported in the Form 5500. See U.S. Department of Labor (2004).
- 11 Council of Institutional Investors (2005).
- 12 Of course, critics contend that assessing individuals' 401(k) holdings without knowing their entire asset holdings is of limited value. They argue that most people who save through a 401(k) plan also have Social Security, human capital, defined benefit pension wealth, housing, and taxable savings. But for most people taxable savings are miniscule, and their 401(k) plan is their major financial asset. Thus the investment allocation within their 401(k) plan is important.
- 13 In 2005, assets in traditional IRAs accounted for 90 percent of total IRA assets. This share was down slightly from 95 percent in 1997.
- 14 Investment Company Institute (2006a).
- 15 One likely explanation for the lower returns in IRAs is that IRAs are often held by older workers who have rolled over their 401(k) assets. Older workers tend to invest in assets with lower returns to avoid the potentially large fluctuations that are associated with riskier investments.

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APPENDIX

Appendix A

TABLE A1. UNWEIGHTED AND WEIGHTED MEDIAN RATES OF RETURN FOR DEFINED BENEFIT AND 401(k) PLANS, 1988-2004

Year	Unweighted		Weighted	
	Defined benefit	401(k)	Defined benefit	401(k)
1988	9.8	10.1	12.4	12.7
1989	12.0	11.3	19.1	13.7
1990	4.2	5.7	1.0	5.2
1991	15.4	13.1	20.6	13.7
1992	7.1	7.7	6.8	8.5
1993	8.0	8.2	11.9	9.2
1994	0.0	2.3	0.3	3.2
1995	19.6	17.8	23.7	19.3
1996	12.6	12.9	15.0	15.4
1997	16.3	17.4	19.0	19.6
1998	12.1	14.6	14.9	17.8
1999	10.6	12.4	15.5	13.1
2000	-0.3	-4.9	1.8	-2.4
2001	-4.4	-7.1	-5.1	-5.1
2002	-8.2	-11.7	-8.9	-9.5
2003	16.7	19.4	21.2	19.4
2004	9.3	9.7	12.5	10.5
Arithmetic Mean	8.3	8.2	10.7	9.7
Geometric Mean	8.0	7.8	10.2	9.3

Source: Authors' calculations from U.S. Department of Labor (1990-2006).

About the Center

The Center for Retirement Research at Boston College was established in 1998 through a grant from the Social Security Administration. The Center's mission is to produce first-class research and forge a strong link between the academic community and decision makers in the public and private sectors around an issue of critical importance to the nation's future.

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Alaska Division of Retirement and Benefits
Public Employees' Retirement System (PERS) Plan Comparison Chart

Feature	Tier I 1/1/61 - 6/30/86	Tier II Entered on or after 7/1/86	Tier III Entered on or after 7/1/96	Tier IV Entered on or after 7/1/06
Employee Contribution	Pre-tax employee contribution: 6.75% beginning 1/1/87—all others 7.5% beginning 1/1/87—police and fire 9.6% beginning 7/1/99—school district	Pre-tax employee contribution: 6.75% beginning 1/1/87—all others 7.5% beginning 1/1/87—police and fire 9.6% beginning 7/1/99—school district	Pre-tax employee contribution: 6.75% beginning 1/1/87—all others 7.5% beginning 1/1/87—police and fire 9.6% beginning 7/1/99—school district	Pre-tax employee contribution: 8% all employees Employee may make additional contributions.
Employer Contribution	Determined by annual actuarial valuation.	Determined by annual actuarial valuation.	Determined by annual actuarial valuation.	5% DC Account 1.75% Health Plan - determined by annual actuarial valuation after FY07. HRA - Flat dollar amount per employee based on 3% of the employer's average annual employee compensation. .4% Disability - P/F .3 All others
Vesting	Members vest with 5 years of service.	Members vest with 5 years of service.	Members vest with 5 years of service.	100% vested in employee contributions from inception. Vested in employer contributions based on the following schedule: 25% after 2 years of service, 50% after 3 years, 75% after 4 years and 100% after five years.
Qualifications for Retirement	Normal retirement age is 55, with early retirement at age 50; police/fire members can retire at any age after 20 years of police/fire service; all other members can retire at any age after 30 years of membership service. Early retirement reduction will be 1/2% per month or 6% per year for every year less than the required normal retirement age.	Normal retirement age is 60, with early retirement at age 55; police/fire members can retire at any age after 20 years of police/fire service; all other members can retire at any age after 30 years of membership service. Early retirement reduction will be 1/2% per month or 6% per year for every year less than the required normal retirement age.	Normal retirement age is 60, with early retirement at age 55; police/fire members can retire at any age after 20 years of police/fire service; all other members can retire at any age after 30 years of membership service. Early retirement reduction will be 1/2% per month or 6% per year for every year less than the required normal retirement age.	None for investment account. Taxes and penalties may apply if withdrawn before age 59-1/2. See requirements for Retirement Medical Coverage.
Benefit Calculation Formula	Benefit formula is 2% for first 10 years and all years of service prior to July 1, 1986, 2.25% for the next 10 years, 2.5% per year thereafter. Benefit calculation is determined on the average of the high three consecutive years' salary. Police/Fire - 2% X 10, 2.5% over 10.	Benefit formula is 2% for first 10 years, 2.25% for the next 10 years, and 2.5% per year thereafter. Benefit calculation is determined on the average of the high three consecutive years' salary. Police/Fire - 2% X 10, 2.5% over 10.	Benefit formulas did not change; however, the benefit calculation is determined on the average of the high five consecutive years' salary. The benefit calculation for police and fire members is the average of the high three consecutive years regardless of tier (effective 2002).	DC account balance plus investment earnings. May be received in several different payment options. Payout options include lump sum payments, rollovers to another qualified plan, or annuities. Annuities may be taken as a lifetime annuity, joint and survivor annuity, or for a period certain.
Alaska Cost-of-living Increases (COLA)	An Alaska Cost-of-Living Allowance is payable to benefit recipients who remain domiciled in Alaska after retirement. The allowance is \$50 or 10% of the base benefit, whichever is greater.	An Alaska Cost-of-Living Allowance is payable to benefit recipients 65 or older or disability benefit recipients regardless of age who remain domiciled in Alaska after retirement. The allowance is \$50 or 10% of the base benefit, whichever is greater.	An Alaska Cost-of-Living Allowance is payable to benefit recipients 65 or older or disability benefit recipients regardless of age who remain domiciled in Alaska after retirement. The allowance is \$50 or 10% of the base benefit, whichever is greater.	None provided.

More detailed information may be found on the Division website, www.state.ak.us/drb, or in the PERS Information Handbook.

*Credited service includes all service used in the calculation of a retirement benefit.

Feature	Tier I 1/1/61 - 6/30/86	Tier II Entered on or after 7/1/86	Tier III Entered on or after 7/1/96	Tier IV Entered on or after 7/1/06
			the base benefit, whichever is greater.	
Post Retirement Pension Adjustments (PRPA) (Inflation Protection)	PRPA increases granted on an ad hoc basis. If an ad hoc is not granted, tier I employees must be age 60 or over or receiving benefits for 5 years to qualify for the automatic PRPA. The automatic PRPA legislated in 1986 applied to all members regardless of hire date.	Automatic PRPA adjustments to disabled members, retirees 60 and over, and those who have received benefits for 5 years.	Automatic PRPA adjustments to disabled members, retirees 60 and over, and those who have received benefits for 5 years.	None provided.
Retirement Medical Coverage	Medical coverage is provided to all benefit recipients and their eligible dependents. The retiree medical plan premium is paid by the retirement system.	Medical coverage is provided to disabilitants, regardless of age and benefit recipients over age 60 or <ul style="list-style-type: none"> Peace officer/fire members with 25 years of police/fire service all other members with 30 years of membership service and their eligible dependents. The retirement system pays the retiree medical plan premium. Retirees and survivors under age 60 must pay the full premium cost if they want coverage.	Same as Tier II. However, employees must accrue a minimum of 10 years of credited service* , to have system-paid coverage at age 60. Employees with less than 10 years must pay the full premiums as long as they wish to continue medical coverage.	Access to medical coverage at Medicare eligible age with 10 years of service or at any age with 25 years of service for peace officers and firefighters or with 30 years of service for all others. Must retire directly from the system. If not eligible for Medicare, must pay full premium. May use health reimbursement arrangement (HRA) account to pay premiums. Once the HRA is exhausted, member self- pays premiums. When eligible for Medicare, the percentage of premium paid by the retiree or surviving spouse is: 10-14 years of service - 30% 15-19 years - 25% 20-24 years - 20% 25-29 years - 15% 30 years or more - 10%
Disability Benefits	Disability benefits for members: nonoccupational disability benefits are calculated as a normal retirement. Occupational disability provides 40% of the gross monthly compensation. Different occupational disability formula available before 7/1/76.	Disability benefits for members: nonoccupational disability benefits are calculated as a normal retirement. Occupational disability provides 40% of the gross monthly compensation.	Disability benefits for members: nonoccupational disability benefits are calculated as a normal retirement. Occupational disability provides 40% of the gross monthly compensation.	Must be a total and presumably permanent disability whose cause is directly related to performance of duties of the job or an on the job injury. Benefit is 40% of salary, earns service while on occupational disability. Employer continues to make all required contributions as if the member were working, plus the member's required contributions to the DC account, without deduction from the member's disability payment. Disability benefits cease when the member becomes eligible for normal retirement at Medicare eligible age and 10 years of service or at any age with 25 years of service for peace officers and firefighters or with 30 years of service for all others. Medical insurance is available to members receiving disability when member is eligible for a normal retirement.

More detailed information may be found on the Division website, www.state.ak.us/drb, or in the PERS Information Handbook.

*Credited service includes all service used in the calculation of a retirement benefit.

Alaska Division of Retirement and Benefits
Teachers' Retirement System (TRS) Plan Comparison Chart

Feature	Tier I July 1, 1955 – June 30, 1990	Tier II Entered on or after July 1, 1990	Tier III Entered on or after July 1, 2006
Employee Contribution	Pre-tax employee contribution: 8.65% beginning 1/1/91	Pre-tax employee contribution: 8.65% beginning 1/1/91	Pre-tax employee contribution: 8% Employee may make additional contributions.
Employer Contribution	Determined by annual actuarial valuation.	Determined by annual actuarial valuation.	7% - DC account 1.75% Health Plan - determined by annual actuarial valuation after FY07. HRA - Flat dollar amount per employee based on 3% of the employer's average annual employee compensation.
Vesting	Members vest with 8 years of service.	Members vest with 8 years of service.	100% vested in employee contributions from inception. Vested in employer contributions based on the following schedule: 25% after 2 years of service, 50% after 3 years, 75% after 4 years and 100% after five years.
Qualifications for Retirement	Normal retirement age is 55, with early retirement at age 50; teachers can retire at any age after 20 years of membership service.	Normal retirement age is 60, with early retirement at age 55; teachers can retire at any age after 20 years of membership service.	None for investment account. Taxes and penalties may apply if withdrawn before age 59 1/2. See requirements for Retirement Medical Coverage.
Benefit Calculation Formula	Benefit formula is 2% for the first 20 years and all years of service prior to July 1, 1990 , 2.5% thereafter. Benefit calculation is determined on the average of the high three contract salaries.	Benefit formula is 2% for the first 20 years, 2.5% thereafter. Benefit calculation is determined on the average of the high three contract salaries.	DC account balance plus investment earnings.
Alaska Cost-of-living Increases (COLA)	An Alaska Cost-of-Living Allowance is payable to benefit recipients who remain domiciled in Alaska after retirement. The allowance is 10% of the base benefit.	An Alaska Cost-of-Living Allowance is payable to benefit recipients 65 or older or disability benefit recipients regardless of age who remain domiciled in Alaska after retirement. The allowance is 10% of the base benefit.	None provided.

More detailed information may be found on the Division website, www.state.ak.us/drb, or in the TRS Information Handbook.
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Feature	Tier I July 1, 1955 – June 30, 1990	Tier II Entered on or after July 1, 1990	Tier III Entered on or after July 1, 2006
Post Retirement Pension Adjustments (PRPA) (Inflation protection)	PRPA increases granted on an ad hoc basis. If an ad hoc is not granted, tier I employees must be age 60 or over or receiving benefits for 8 years to qualify for the automatic PRPA. The automatic PRPA legislated in 1990 applied to all members regardless of hire date.	Automatic PRPA adjustments to disabled members, retirees 60 and over, and those who have received benefits for 8 years.	None provided.
Retirement Medical Coverage	Medical coverage is provided to all benefit recipients and their eligible dependents. The retiree medical plan premium is paid by the retirement system.	The retirement system pays the retiree medical plan premium for all disabilitants regardless of age, for retirees and survivors over age 60 and for retirees with at least 25 years of membership service. This coverage includes eligible dependents. Retirees and survivors under age 60, with less than 25 years of membership service must pay the full premium cost if they want coverage.	Access to medical coverage at Medicare eligible age with 10 years of service or at any age with 30 years of service. Must retire directly from the system. If not eligible for Medicare, must pay full premium. May use health reimbursement arrangement (HRA) account to pay premiums. Once the HRA is exhausted, member self- pays premiums. When eligible for Medicare, the percentage of premium paid by the retiree or surviving spouse is: 10-14 years of service - 30% 15-19 years - 25% 20-24 years - 20% 25-29 years - 15% 30 years or more - 10%
Disability Benefits	Disability benefits are 50% of base salary, plus 10% for each eligible dependent child up to a maximum of 4 children.	Disability benefits are 50% of base salary, plus 10% for each eligible dependent child up to a maximum of 4 children.	Must be a total and presumably permanent disability whose cause is directly related to performance of duties of the job or an on the job injury. Benefit is 40% of salary, earns service while on occupational disability. Employer continues to make all required contributions as if the member were working, plus the member's required contributions to the DC account, without deduction from the member's disability payment. Disability benefits cease when the member becomes eligible for normal retirement at Medicare eligible age and 10 years of service or at any age with 30 years of service. No medical insurance until eligible for normal retirement.

More detailed information may be found on the Division website, www.state.ak.us/drbb, or in the TRS Information Handbook.
G:/publications/handbooks/trs tier chart.doc (Rev. 3/06)

**SENATOR KIM ELTON
MEMORANDUM**

February 18, 2009

To: Legislative Legal Services
From: Jesse Kiehl
Re: SB 23

Please draft a blank CS for SB 23 with the following changes:

1. Rather than repeal the defined contribution system, the CS should allow certain new employees a choice between the DC plan and the appropriate DB tier.
2. The choice should be limited to new hires fully vested in a defined benefit pension system other than PERS and TRS, but not including Social Security. A new hire with previous PERS or TRS service does not qualify to make the choice.
3. New hires who do not meet this requirement will be hired into the appropriate DB tier.
4. Those employees who qualify for the choice must make an irrevocable election within 60 calendar days of hire.
5. An employer must provide new hires eligible to choose with information prepared by the administrator within five calendar days of hire. The administrator must prepare information to clearly inform the employee of the potential consequences of the employee's election.
6. Please retain the conversion election provisions for current DC plan employees (sections 34 and 35 of the bill). It needs to be clear that a person making the irrevocable election described in point four (above) cannot subsequently use the conversion election provisions.

Sen. Elton would like to present the new CS to the chairman of the Labor & Commerce Committee on the morning of Tuesday, February 23. I realize this is short notice for a tall order. I appreciate your help.

February 12, 2009

VIA EMAIL

Mr. Pat Shier
 Director
 Division of Retirement and Benefits
 Department of Administration
 State of Alaska
 333 Willoughby Avenue
 6th Floor State Office Building
 Juneau, AK 99811-0208

**Re: Alaska PERS and TRS
 Comparison of DB versus DCR Ongoing Costs**

Dear Pat:

As requested, we are providing a comparison of the costs between the Defined Benefit (DB) plans and the Defined Contribution Retirement Plan (DCR) for the State of Alaska Teachers' Retirement System (TRS) and Public Employees' Retirement System (PERS). The results provided represent employer costs as a percent of pay for FY11 and are net of member contributions. The comparison is between the most recent tier of the DB plan (Tier 2 for TRS, Tier 3 for PERS) and the DCR Plan (Tier 3 for TRS, Tier 4 for PERS). The rates were determined using the payroll applicable to each group and are not based on total payroll.

RESULTS

The following results compare the DB and DCR ongoing plan costs:

Public Employees' Retirement System (All Members)	DB Plan Tier 3	DCR Plan Tier 4*
DB Plan Employer Normal Cost Rate	2.97%	N/A
DC Employer Contribution Rate	N/A	5.00%
Occupational Death and Disability Normal Cost Rate	N/A	0.38%
Medical Normal Cost Rate	7.98%	0.85%
HRA Contribution Rate	N/A	3.00%
Total	10.95%	9.23%

* Based on results as of June 30, 2007. Updated results as of June 30, 2008 will be ready in the next few weeks.

Normal Cost

Employer Normal Cost Rate	PERS Pension	PERS Medical	PERS Total	# of Members ¹
Tier 1 (DB)±	9.15%	10.46%	19.61%	27,561
Tier 2 (DB) ±	5.33%	10.41%	15.74%	16,331
Tier 3 (DB)‡	2.97%	7.98%	10.95%	27,466
Tier 4 (DC)‡	5.38%	3.85%	9.23%	9,211

¹ DRB data dated February, 2009

Employer Normal Cost Rate	TRS Pension	TRS Medical	TRS Total	# of Members ²
Tier 1 (DB)±	7.18%	8.02%	15.20%	11,615
Tier 2 (DB)‡	2.71%	6.25%	8.96%	9,782
Tier 3 (DC)‡	7.32%	4.08%	11.40%	2,415

± rates per Buck Consultants letter March, 2007

² DRB data dated February, 2009

‡ rates per Buck Consultants letter February, 2009

Accrued Liability³

Accrued Liability (DB)	PERS Pension	PERS Medical	PERS Total	TRS Pension	TRS Medical	TRS Total
Tier 1	\$5,628,778	\$4,036,751	\$9,665,530	\$3,925,023	\$1,816,223	\$5,741,247
Tier 2	1,123,559	1,334,674	2,458,233	409,562	347,748	757,309
Tier 3	334,854	386,224	721,078	N/A	N/A	N/A
Total	\$7,087,191	\$5,757,650	\$12,844,841	\$4,334,585	\$2,163,971	\$6,498,556
Assets ^o			\$8,442,919			\$3,958,939
Accrued Liability			\$4,401,922			\$2,539,617

³ per Buck Consultants letter, March 2007

^oPERS DB net assets as of 6/30/2008 were \$10,726,913,000.

TRS DB net assets as of 6/30/2008 were \$4,804,371,000.

Pensionomics:

Measuring the Economic Impact of State and Local Pension Plans

Key Findings

Benefits paid by state and local pension plans support a significant amount of economic activity in the state of Alaska.

Pension benefits received by retirees are spent in the local community. This spending ripples through the economy, as one person's spending becomes another person's income, creating a *multiplier effect*.

Expenditures stemming from state and local pensions supported...

- 6,270 jobs that paid \$385.2 million in wages and salaries
- \$1.0 billion in total economic output
- \$155.5 million in federal, state, and local tax revenues

... in the state of Alaska

Each dollar paid out in pension benefits supported \$1.25 in total economic activity in Alaska.

Each dollar "invested" by Alaska taxpayers in these plans supported \$6.35 in total economic activity in the state.

Overview

Expenditures made by retirees of state and local government provide a steady economic stimulus to Alaska communities and the state economy. In 2006, 34,962 residents of Alaska received a total of \$819.50 million in pension benefits from state and local pension plans, with \$808.64 million paid from plans within the state and the remainder originating from plans in other states.

The average pension benefit received was \$1,953 per month or \$23,440 per year. These modest benefits provide retired teachers, public safety personnel and others who served the public during their working careers income to meet basic needs in retirement.

Impact on Jobs and Incomes

Retiree expenditures stemming from state and local pension plan benefits supported 6,270 jobs in the state. The total income to state residents supported by pension expenditures was \$385.2 million.

Of this, the greatest share, \$188.0 million, was comprised of employee compensation (wages and salaries). Proprietors' income (self-employment income) represented \$33.6 million, and other property income (including payments from interest, rent, royalties, profits and dividends) totaled \$163.6 million.

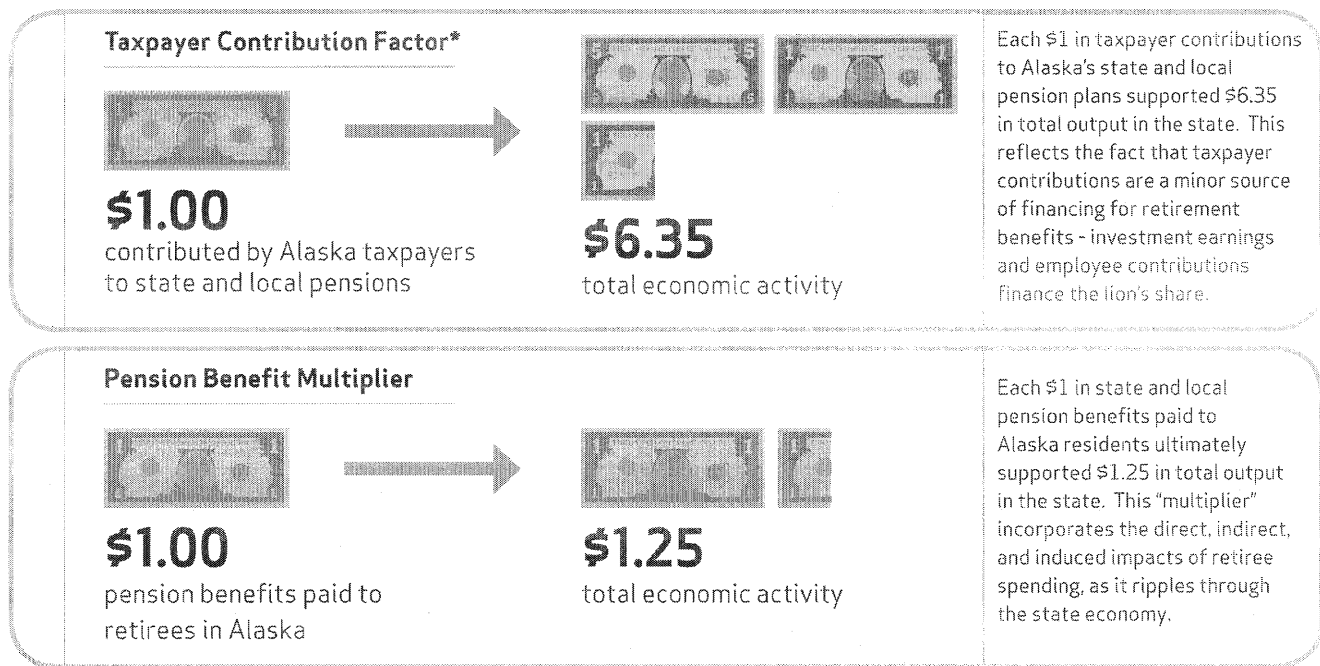
Economic Impact

State and local pension funds in Alaska and other states paid a total of \$819.50 million in benefits to Alaska residents in 2006. Retirees' expenditures from these benefits supported a total of \$1.0 billion in total economic output in the state, and \$430.7 million in value added in the state.

\$790.8 million in direct economic impacts were supported by retirees' expenditures on goods and services from businesses in the state. An additional \$120.4 million in indirect economic impact resulted when these businesses purchased additional goods and services, generating additional income in the local economy. \$112.8 million in induced impacts occurred when employees hired by businesses as a result of the direct and indirect impacts made expenditures, supporting even more additional income.



Economic Multipliers



* Caution should be used in interpreting this number, because the Census data used reflect the taxable status of contributions only; because employee contributions may be reported as taxpayer contributions, the multiplier here may be underestimated.

Impact on Tax Revenues

State and local pension payments made to Alaska residents supported a total of \$155.5 million in revenue to federal, state and local governments. Taxes paid by retirees and beneficiaries directly out of pension payments totaled \$28.7 million. Taxes attributable to direct, indirect and induced expenditures accounted for \$126.8 million in tax revenue.

Federal Tax	87.5 million
State/Local Tax	67.8 million
Other Corporate Taxes	0.2 million
Total	\$155.5 million

Economic Impacts by Industry Sector

The economic impact of state and local pension benefits was broadly felt across various industry sectors in the state. The ten industry sectors with the largest employment impacts are presented in the table below.

Industry	Employment Impact (# Jobs)	Value Added Impact (\$ millions)	Income Impact (\$ millions)	Output Impact (\$ millions)
Health Care and Social Assistance	1,354	\$75.0	\$74.2	\$119.1
Retail Trade	1,331	64.4	50.9	97.0
Accommodation and Food Services	839	26.7	23.8	50.0
Other Services (Except Public Administration)	479	14.2	13.3	27.1
Real Estate and Rental and Leasing	452	33.8	28.2	50.8
Professional, Scientific, and Technical Services	229	11.8	11.5	23.2
Arts, Entertainment, and Recreation	229	6.2	5.6	10.8
Finance and Insurance	227	24.2	23.3	43.9
Public Administration	196	10.1	10.1	20.7
Transportation and Warehousing	187	11.4	10.8	22.0



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NEWS Release

Contact: Kelly Kenneally
202.457.8190
kkenneally@nirsonline.org

NEW STUDY FINDS 6,270 JOBS, \$1 BILLION ECONOMIC IMPACT FROM ALASKA'S PUBLIC PENSION SYSTEMS

Analysis Determines Pensions Leave Substantial Economic Footprint

WASHINGTON, D.C., FEBRUARY 26, 2009 – An economic impact analysis released today finds that the benefits provided by Alaska's public pension plans have a sizable impact that ripples across the state and touches every industry. The new report, "*Pensionomics: Measuring the Economic Impact of State and Local Pension Plans*," finds that expenditures made from Alaska's public pension benefits for fiscal year 2005-2006:

- Had a total economic impact of more than \$1 billion.
- Supported more than 6,270 jobs that paid more than \$385.2 million in total compensation to Alaska's workers.
- Supported more than \$155.5 million in annual federal, state, local tax revenue.
- Paid \$819.5 million in pension benefits to 34,962 retirees and beneficiaries.
- Had large multiplier effects. Each taxpayer dollar invested in Alaska's public pensions supported \$1.25 in total economic activity, while each dollar paid out in benefits supported \$6.35 in economic activity.
- Impacted every industry in the state.

A detailed Alaska economic impact Fact Sheet is available at www.nirsonline.org. The report also analyzes the national economic impact of public pensions to find 2.5 million jobs and \$358 billion in economic activity supported by state and local pensions.

"This study measures the magnitude of the 'multiplier effect' of Alaska's public pensions across the state's economy," said Ilana Boivie, NIRS policy analyst and report co-author. "The multiplier effect occurs because one retiree's spending in Alaska becomes another person's income," she said.

Boivie explained, "For example, a retired Alaska teacher may spend his or her pension check to pay the gas bill, buy a car, or make purchases at the local pharmacy, grocery store, or movie theatre. As a result of the retiree's spending, businesses see an increase in their income, which then enables businesses to spend and create jobs. Each successive round of spending ripples through the Alaska economy to generate an economic impact that is much larger than the initial spending by the retiree."

--more--

“Understanding the considerable economic impact of Alaska’s public pensions is vital given the severe financial crisis facing America,” said Beth Almeida, NIRS executive director and report co-author. “Economists have long known that the steady monthly income provided by pensions can act as an ‘automatic stabilizer.’ That is, retirees with a stable monthly pension income can continue to spend on basic needs, even during an economic downturn. In contrast, retirees relying solely on plummeting 401(k)s or individual retirement accounts likely are forced to retreat from spending precisely at the time when the Alaska economy most needs stimulus,” Almeida explained.

The analysis was conducted using data from the U.S. Census Bureau and IMPLAN, an input-output modeling software widely used by industry and governments.

NIRS will hold a conference call regarding the findings on Thursday, February 26, 2009 at 11 AM ET by dialing (800) 230-1074, Confirmation Number: 988166.

A live PowerPoint presentation will be available online during the conference call. Log on to the web conference by visiting www.gotomeeting.com. On the left hand column of the page, click "Join Meeting." When prompted, enter Meeting Number 193-429-659. Enter the requested information to access the presentation.

The Report, State Fact Sheets, and PowerPoint Presentation will be available in advance of the call at www.nirsonline.org on Feb. 26th at 9 AM ET.

An audio digitized replay of the call will be available from February 26, 2009 at 1 PM ET through March 26, 2009 at 11:59 PM ET by dialing (800) 475-6701, Access Code 988166.

ABOUT NIRS

NIRS is a non-profit, non-partisan organization established to contribute to informed policymaking by fostering a deep understanding of the value of retirement security to employees, employers, and the economy as a whole. Located in Washington, D.C., NIRS's membership includes employee benefit plans, agencies that manage retirement plans, trade associations, financial services firms, and other retirement service providers.

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Pensions & Investments

Pionline.com

Mercer to acquire Callan Associates

By **Douglas Appell**

Source: Pensions & Investments

Date: February 17, 2009

Updated

Mercer will acquire Callan Associates and will merge the investment consulting businesses of the two firms in about late March, both companies announced this morning. Terms of the deal weren't disclosed.

The combined entity will boast roughly 1,100 investment consulting employees in 41 offices around the world.

Asked if the combination would entail layoffs, as both firms already have offices in cities such as San Francisco, Atlanta and Chicago, executives from both firms said there were no plans to cull either consultants or research staff.

In a telephone interview, Greg Allen, Callan's president, said for a people-intensive business such as investment consulting, "you can't take consultants with a full book of 15 to 20 clients and give them 30." The goal will be to minimize any disruption for clients as the two big firms are integrated, executives said.

In a joint news release, Ronald D. Peyton, Callan's chairman and CEO, said with Callan's strength in the U.S. market and Mercer's global reach, "we can offer clients a wider range of tools and resources, top-notch professional advice and enhanced research, educational and quantitative services."

Charles Salmans, a Mercer spokesman, said the Callan Investments Institute, an educational forum that hosts conferences for member institutional investors and money managers, will be retained by the combined entity. Mercer had ended its own conference program amid heightened concerns about potential conflicts of interest in the wake of a market timing scandal that hit the money management industry from late 2003.

In a telephone interview with top Mercer and Callan executives, Jeff Schutes, Mercer's U.S. investment consulting leader, said the two firms' combined investment consulting lineup would boast resources and "depth" unsurpassed in the industry.


Mr. Salmans said each firm brings roughly a 10% share of the U.S. investment consulting market to the table. With \$4 trillion in client assets under advisement, the combined entity would be about twice the size of its next biggest competitor — Watson Wyatt Worldwide — with the heft making the combined entity an employer of choice in the industry, Mr. Peyton said.

Executives said initial feedback from clients this morning has been positive.

Callan's Mr. Allen said for clients of his U.S.-focused firm, Mercer's global reach should prove a big benefit. The enhanced scale should offer a number of advantages, from deeper insights on global trends to more relevant databases.

Some industry executives noted that scale could prove a two-edged sword. Economies of scale can be

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advantageous in areas such as back-office operations, but for other key services, such as finding the best active managers for clients, there's a tipping point beyond which size could prove a hindrance, noted Timothy R. Barron, president and CEO of investment consultant RogersCasey Inc.

Callan executives said they have 175 financial professionals, while Mercer executives said they have 200 in the U.S. and another 700 elsewhere around the globe. Executives from both companies rejected speculation that the deal was designed, in part, to provide an exit strategy for a generation of Callan executives approaching retirement age.

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FISCAL NOTE

STATE OF ALASKA
2009 LEGISLATIVE SESSION

~~SECRET~~
ADVER 45 yrs. old
10 yrs. service

Fiscal Note Number: _____
Bill Version: SB 023
() Publish Date: _____

Identifier (file name): SB023-DOA-DRB-02-24-09 Dept. Affected: Statewide
Title An Act repealing the defined contribution retirement plans for RDU Statewide
teachers and for public employees.... Component Statewide
Sponsor Senators ELTON, Ellis, French, Wielechowski, Menard,....
Requester Senate Labor & Commerce Committee Component Number _____

Expenditures/Revenues (Thousands of Dollars)

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

	Appropriation Required		Information				
	FY 2010	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
OPERATING EXPENDITURES							
Personal Services	0.0	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	0.0
Contractual	0.0	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	0.0
Equipment	0.0	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	0.0
Grants & Claims	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Miscellaneous	0.0	0.0	37,559.0	16,101.0	16,637.0	17,223.0	17,868.0
TOTAL OPERATING	0.0	0.0	37,559.0	16,101.0	16,637.0	17,223.0	17,868.0

CAPITAL EXPENDITURES							
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CHANGE IN REVENUES ()							
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FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts	0.0	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	0.0
1004 GF	0.0	0.0	37,559.0	16,101.0	16,637.0	17,223.0	17,868.0
1005 GF/Program Receipts	0.0	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	0.0
Other Interagency Receipts	0.0	0.0	0.0	0.0	0.0	0.0	0.0
TOTAL	0.0	0.0	37,559.0	16,101.0	16,637.0	17,223.0	17,868.0

Estimate of any current year (FY2008) cost: _____

POSITIONS

Full-time	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Part-time	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Temporary	0.0	0.0	0.0	0.0	0.0	0.0	0.0

ANALYSIS: (Attach a separate page if necessary)

This legislation acts to repeal the hybrid defined contribution retirement (DCR) plan for teachers and for public employees and enroll new employees in the last tier of the defined benefit (DB) plans for both pension and retiree medical benefits (TRS Tier II, PERS Tier III). Existing DCR plan participants will be given a one-time opportunity to convert their DCR accounts to the DB plan. The legislation also moves the authority to approve an annual cost of living increase available only to Tier I DB members, the Ad Hoc Post Retirement Pension Adjustment (PRPA), from the Commissioner of Administration to the Alaska Retirement Management Board and removes the requirement for 105% funding of the systems before an Ad Hoc PRPA can be issued. A breakdown of the costs for this bill between the PERS and TRS systems is contained on page two of this fiscal note. Since employer rates are capped at 22% for PERS and 12.56% for TRS, all increased costs are a liability of the state.

Prepared by: Patrick Shier, Director
Division: Retirement and Benefits
Approved by: Rachael Petro, Deputy Commissioner
Department of Administration

Phone 465-4817
Date/Time 2/26/09 10:25 AM
Date _____

FISCAL NOTE

STATE OF ALASKA
2009 LEGISLATIVE SESSION

BILL NO. _____ **SB 023**

ANALYSIS CONTINUATION

The immediate cost to the State to eliminate the unfunded liabilities created by this change is approximately \$15.2 million for PERS and \$6.8 million for TRS and is included in the FY11 column.

I. The tables in the section below show the cost of the bill for fiscal years 2011 through 2015 if the DCR Plan for pension and medical benefits is repealed and members revert back to the DB plans. Costs are based on PERS system payroll of \$2 billion and TRS system payroll of \$667 million annually. It is further assumed that payroll will grow by 4% per year and that all current DCR members will become members of the latest tier of DB plans and employer assets from the DCR plans will be transferred to the DB plans. Contribution rates have already been set for FY10 so costs are reflected beginning in FY11.

Dollars are in thousands.

PERS	FY 10	FY 11	FY 12	FY 13	FY 14	FY 15
Increase in Normal Cost Amount	\$0.00	\$13,077	\$13,491	\$13,946	\$14,444	\$14,994
Increase in Past Service Cost	\$0.00	\$15,182	\$0	\$0	\$0	\$0
Total Increase in Annual State Contribution Amount	\$0.00	\$28,259	\$13,491	\$13,946	\$14,444	\$14,994

TRS	FY 10	FY 11	FY 12	FY 13	FY 14	FY 15
Increase in Normal Cost Amount	\$0.00	\$2,537	\$2,610	\$2,691	\$2,779	\$2,874
Increase in Past Service Cost	\$0.00	\$6,763	\$0	\$0	\$0	\$0
Total Increase in Annual State Contribution Amount	\$0.00	\$9,300	\$2,610	\$2,691	\$2,779	\$2,874

II. The tables in the section below show the change in the normal cost rate and unfunded accrued liability. Dollars are in thousands.

Pension Only	PERS	TRS
Change in Employer Normal Cost Rate	0.34%	0.27%
Change in Unfunded Accrued Liability after transfer of DCR assets.	(\$7,393)	(\$1,747)
Change in Total Employer Rate	0.32%	0.25%

(Wash)

Healthcare Only	PERS	TRS
Change in Employer Normal Cost Rate	1.41%	1.18%
Change in Unfunded Accrued Liability after transfer of DCR assets.	\$22,575	\$8,510
Change in Total Employer Rate	1.49%	1.26%

=> Failure of DC plan

Total	PERS	TRS
Change in Employer Normal Cost Rate	1.75%	1.45%
Change in Unfunded Accrued Liability after transfer of DCR assets.	\$15,182	\$6,763
Change in Total Employer Rate	1.81%	1.51%

Jeff Stepp

From: Brooks, Kevin A (DOA) [kevin.brooks@alaska.gov]
Sent: Thursday, February 26, 2009 1:03 PM
To: Jesse Kiehl; Jeff Stepp; Sen. Joe Paskvan
Cc: Kreitzer, Annette E (DOA); Rowland, Mindy B (GOV); Shier, Patrick J (DOA)
Subject: Follow-up on SB23 Questions

Sen. Paskvan et al.:

I have just spent the last hour on the telephone with our actuary at Buck Consultants and have answers to the questions raised in our meeting this morning.

- 1) Does the fiscal note analysis reflect a % or number of DCR members coming into the DB plan that will not ultimately vest in health benefits?

Yes, the actuarial model contemplates that not all members will vest in health benefits.

- 2) Does the fiscal note analysis reflect that current DCR members would have accrued a health benefit under the current system, and adjust the DB health projection accordingly?

Yes, the actuarial model transfers all assets and accrued liabilities related to health benefits in the DCR plan to the DB plan, and calculates the new anticipated cost of DB health benefits only. There is no "double-counting" of benefits.

- 3) What is the disposition of Health Reimbursement Account (HRA) assets in the fiscal note analysis?

HRA assets are transferred into the DB plan with other DCR assets and offset the unfunded liability related to health benefits.

- 4) In Buck's February 12, 2009 letter to Pat Shier (RE: Alaska PERS and TRS Comparison of DB versus DCR Ongoing Costs), the TRS Tier 2 rate of 8.96% is lower than the TRS Tier 3 rate of 11.44%. The table in the fiscal note shows a TRS normal cost increase of 1.45% as a result of the bill. How does the rate go from 2.44% lower to 1.45% higher?

The two analyses address related but different questions. The rates in the February 12 letter were determined using the payroll applicable to each group and are not based on total payroll. We have asked Buck to prepare an analysis that walks through the rate development methodology and shows how the rates are related. We expect that analysis by early next week (March 2 or 3). Buck has confirmed that the fiscal note analysis is correct.

Based on this information, we are confident that the fiscal note submitted to the committee this morning accurately reflects the cost of the bill.

Please let me know if you have any questions or require additional information.

Sincerely,

Kevin Brooks
 Deputy Commissioner
 Department of Administration

ALASKA STATE LEGISLATURE

Senate Labor & Commerce Committee

Senator Paskvan, Chair
Senator Thomas, Vice-Chair
Senator Davis
Senator Meyer
Senator Bunde



State Capitol Building, Room 7
Juneau, Alaska 99801-1182
Phone (907) 465-3709
Fax (907) 465-4714
sen.joe.paskvan@legis.state.ak.us

To: Leg Legal

From: Senator Joe Paskvan

Date: February 26, 2009

Re: CS for SB 84 with attached amendment

SB 84 was moved from (S) L&C this afternoon with the attached amendment. Please revise the bill with the appropriate language and send a final draft to this office.

If you have questions, please contact Jeff Stepp at 465-4747.

Thank you very much.

AMENDMENT

OFFERED IN THE SENATE

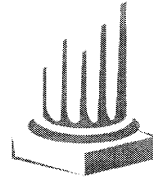
BY SENATOR MEYER

TO: SB 84

Section 2 is amended to read:

* Sec. 2. AS 44.88.095 (g) is amended to read:

(g) Before July 1, 20[07]14, the authority may issue bonds in an amount greater than \$10,000,000 to assist in the financing of a development project under AS 44.88.172 - 44.88.177 only with legislative approval ,excluding refunding bonds. Refunding bonds may be issued without further approval by law in a principal amount sufficient to provide funds for the payment of all bonds to be refunded by them, and, in addition, for the payment of all other amounts that the authority considers appropriate in connection with the refunding, including expenses incident to the redeeming, calling, retiring, or paying of the outstanding bonds, the funding of reserves, and the issuance of the refunding bonds. Beginning July 1, 20[07]14, and thereafter, without prior legislative approval, the authority may not issue bonds, except refunding and conduit revenue bonds.



Biography of Beth Almeida
Executive Director
National Institute on Retirement Security

In November 2007, Beth Almeida was named the first executive director of the National Institute on Retirement Security. With the Board of Directors, Almeida leads the organization's strategic planning, research and education initiatives. During NIRS first full year of operation, she directed the successful completion of six research products that are enhancing the American debate on retirement security challenges.

Before joining NIRS, Ms. Almeida served as assistant director for strategic resources and as senior economist with the International Association of Machinists and Aerospace Workers. There, she was instrumental in transitioning some 40,000 airline employees out of terminating or freezing pensions into the IAM's multi-employer defined benefit pension plan.

Ms. Almeida also led research initiatives with the Center for European Integration Studies at the University of Bonn, Germany; the European Institute for Business Administration in Fontainebleau, France; and the Center for Industrial Competitiveness at the University of Massachusetts Lowell.

She speaks regularly at conferences from coast-to-coast and internationally regarding economics, pensions, and retirement security issues and is regularly cited in national, local, trade and international news reports. Ms. Almeida also serves on the Advisory Board of Center for Retirement Research at Boston College's initiative on state and local government pensions, and on the Executive Board of the Labor & Employment Relations Association.

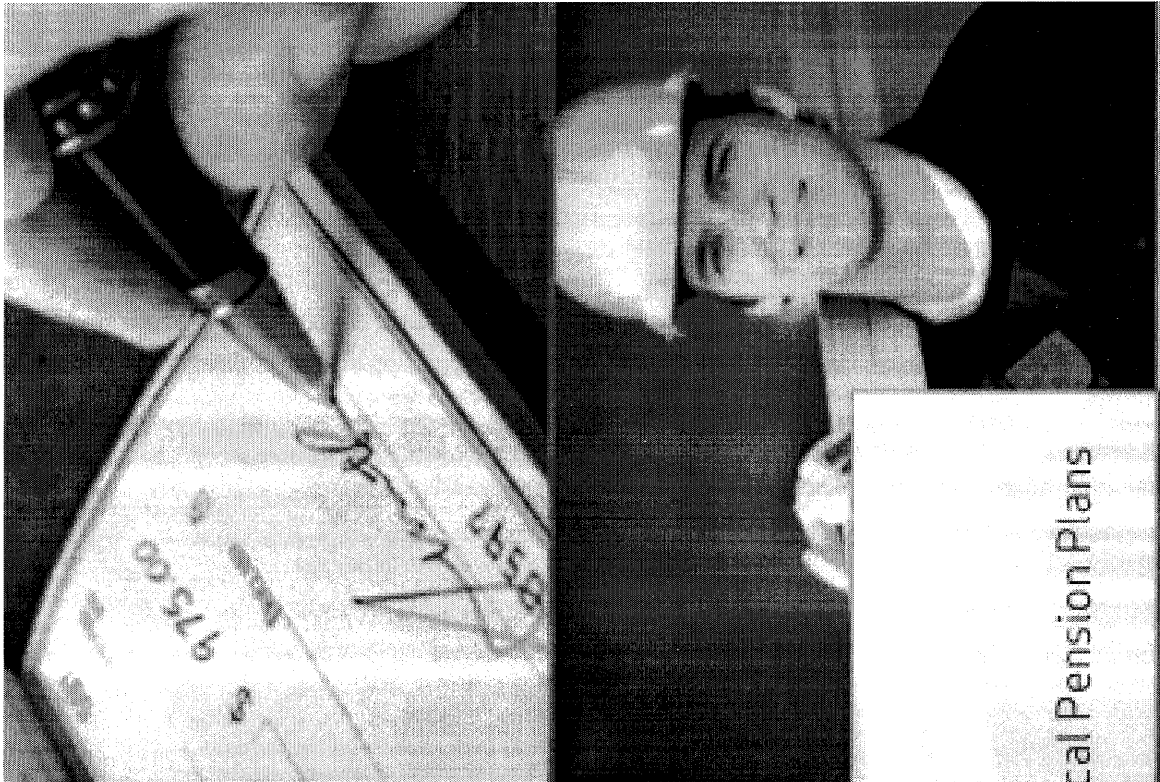
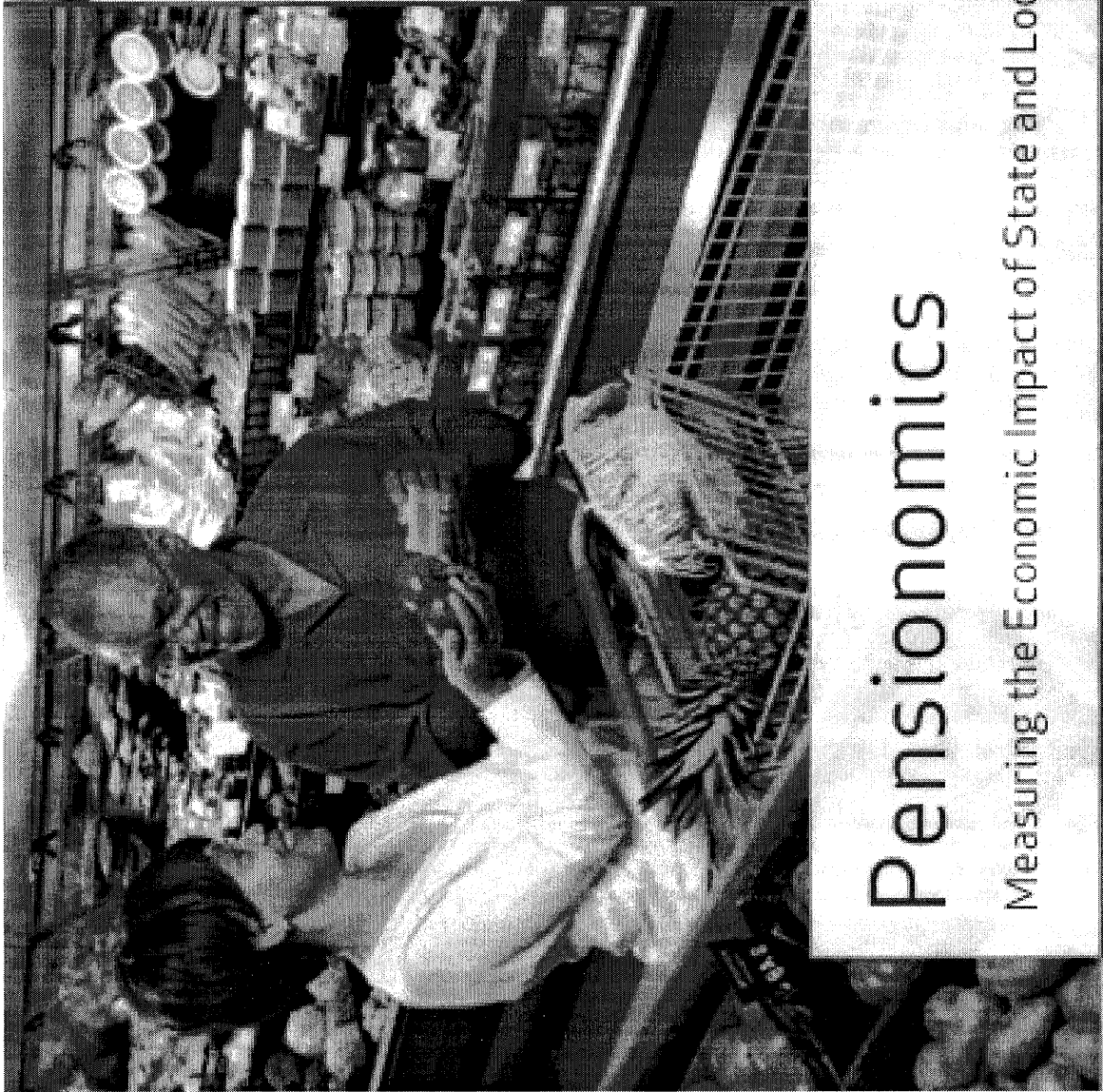
Ms. Almeida earned a bachelor's degree in international business from Lehigh University and a master's degree in economics from the University of Massachusetts Amherst.

Pensionomics: Measuring the Economic Impact of State and Local Pension Plans

**Testimony of Beth Almeida, Executive Director
To the Senate Labor and Commerce Committee
Legislature of the State of Alaska
February 26, 2009**



**NATIONAL INSTITUTE ON
Retirement Security**



Pensionomics

Measuring the Economic Impact of State and Local Pension Plans

by Ilana Boivie and Beth Almeida

February 2009

Why We Did this Study

- Measure the “economic footprint” of state and local pension plans, both nationally and within states.
- DB plans act as an “automatic stabilizer” for the economy
 - Even in tough times, retirees with a reliable pension can maintain spending on basic needs
- Get a sense of how much of a stabilizing effect state and local pensions may have on the U.S. economy and state economies.



What We Found - Nationally

- In 2006, expenditures made out of state and local retirement benefits supported...
 - **2.5 million jobs** that paid **\$92 billion** in income
 - **\$358 billion** in economic output nationwide
 - **\$57 billion** in federal, state, and local tax revenue



What We Found - Alaska

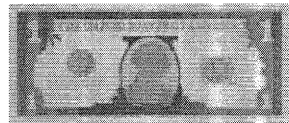
- In 2006, expenditures made out of state and local retirement benefits supported...
 - **6,270 jobs** that paid **\$385 million** in income
 - **\$1 billion** in economic output statewide
 - **\$155 million** in federal, state, and local tax revenue



What We Found - Alaska

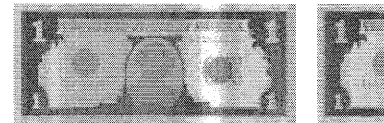
- For every dollar paid out in benefits, \$1.25 in total economic activity was supported in the state.

Pension Benefit Multiplier



\$1.00

pension benefits paid to
retirees in Alaska



\$1.25

total economic activity

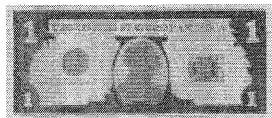


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What We Found - Alaska

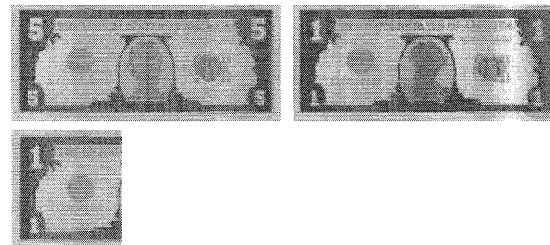
- For every dollar contributed by taxpayers, \$6.35 in economic activity was supported in the state.

Taxpayer Contribution Factor*



\$1.00

contributed by Alaska taxpayers
to state and local pensions



\$6.35

total economic activity



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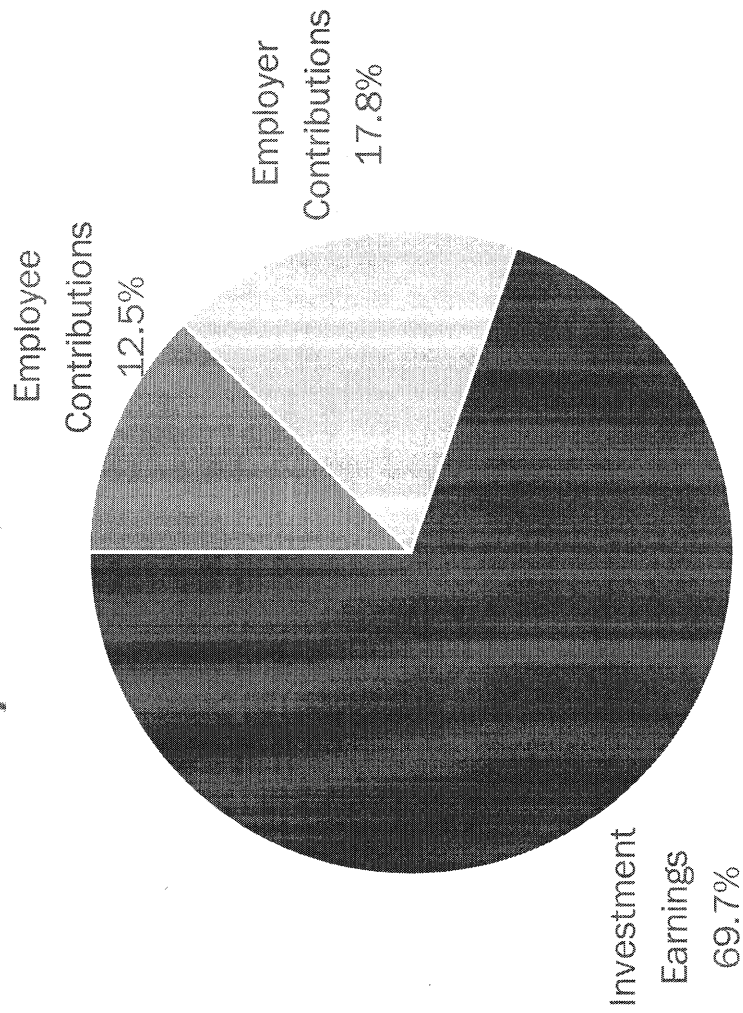
Overview of State and Local DB Pensions in Alaska

- According to the U.S. Census Bureau, close to 35,000 Alaskans received pension benefits from state and local pensions in 2006.
- Retired Alaskans received roughly \$819 million in benefit payments in 2006.
- The average pension was \$1,953 per month, or \$23,440 per year.



Financing of State and Local Pension Plans in Alaska

Aggregate Contributions by Source,
1993-2006



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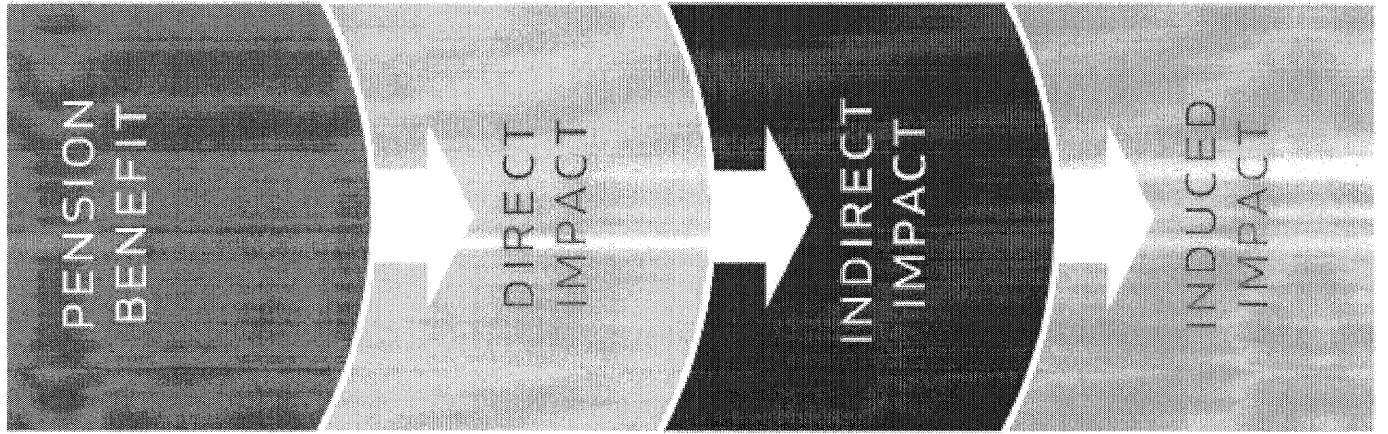
Pension Plans' Economic Impacts

- Pension plans can support economic activity through several channels, for example,
 - **Benefit channel** – retirees' expenditures create incomes for others in the economy
 - **Investment channel** – the investment of pension assets provides capital to businesses to develop products, invest in new technologies, create jobs.
- This study focuses on the benefit channel



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Figure 2:
The Multiplier Effect: How Spending Ripples Through the Economy, Supporting Jobs and Incomes in the Process



A retired schoolteacher...

...uses her pension money to buy a car.

As a result of that purchase, the owner of the car dealership, the car salesman, and each of the companies involved in the production of the car all see an increase in income, and spend that additional income.

These companies hire additional employees as a result of this increased business, and those new employees spend their paychecks in the local economy.



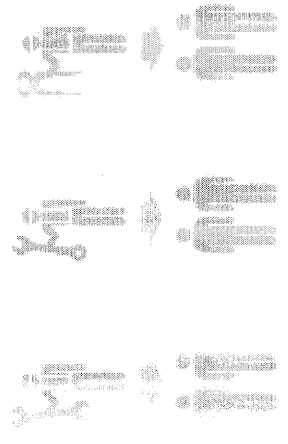
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\$\$



\$\$\$



Methodology

What We Did

- Began with benefit payment data from the U.S. Census Bureau's State & Local Government Employee Retirement System survey.
- Estimated taxes paid out of benefits using data from CBO and Edwards and Wallace (2004).
- Adjusted Census benefit payment data to account for migration of retirees from one state to another.
- Using IMPLAN input-output modeling software, estimated the economic impacts of retiree expenditures and taxes.



What is IMPLAN?

- IMPLAN is an input-output modeling software originally developed for a USDA Forest Service project, now used for many types of analysis.
- It represents relationships among various sectors in the economy as a matrix. It estimates how an initial event reverberates through the economy.
- IMPLAN was used to estimate the following economic impacts: jobs, incomes, value added, total output, and tax revenue.

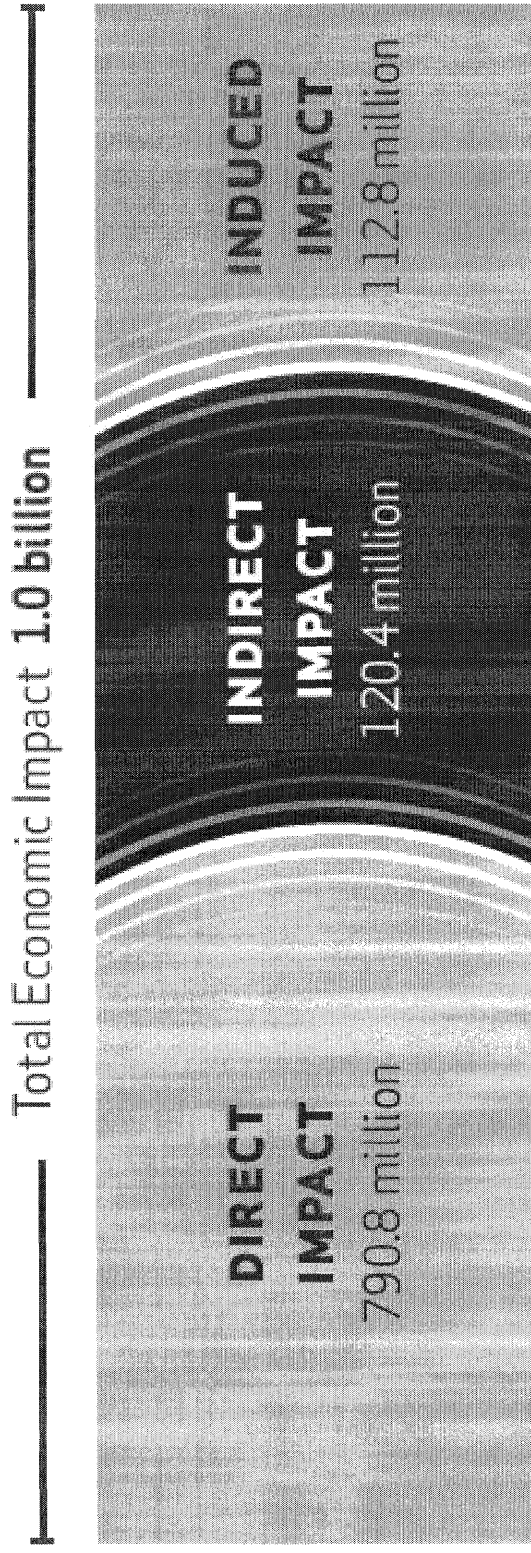


Results – Economic Impact in Alaska

- In 2006, expenditures made out of state and local retirement benefits supported...
 - **6,270 jobs** that paid **\$385 million** in income
 - **\$1 billion** in economic output statewide
 - **\$155 million** in federal, state, and local tax revenue



Alaska Results: Total Economic Impact



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Alaska Results: Tax Revenue Impact

Federal Tax	87.5 million
State/Local Tax	67.8 million
Other Corporate Taxes	0.2 million
Total	\$155.5 million



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Alaska Results: Economic Impacts by Industry

- Industries with most jobs supported
 - Health Care and Social Assistance: 1,354 jobs
 - Retail Trade: 1,331 jobs
 - Accommodation and Food Services: 839 jobs
- Industries where greatest economic impact felt
 - Health Care and Social Assistance: \$119 million
 - Retail Trade: \$97 million
 - Real Estate, Rental, Leasing: \$51 billion



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Alaska Results: Economic Impacts by Industry

Industry	Employment Impact (# Jobs)	Value Added Impact (\$ millions)	Income Impact (\$ millions)	Output Impact (\$ millions)
Health Care and Social Assistance	1,354	\$75.0	\$74.2	\$119.1
Retail Trade	1,331	64.4	50.9	97.0
Accommodation and Food Services	839	26.7	23.8	50.0
Other Services (Except Public Administration)	479	14.2	13.3	27.1
Real Estate and Rental and Leasing	452	33.8	28.2	50.8
Professional, Scientific, and Technical Services	229	11.8	11.5	23.2
Arts, Entertainment, and Recreation	229	6.2	5.6	10.8
Finance and Insurance	227	24.2	23.3	43.9
Public Administration	196	10.1	10.1	20.7
Transportation and Warehousing	187	11.4	10.8	22.0



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Alaska Results: Pension Expenditure Multiplier

- What is the total economic impact of each dollar paid out in pension benefits?
- An expenditure multiplier measures the size of the “ripple effect” of retirees’ expenditures



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Alaska Results: Taxpayer Contribution Factor

- What is the “return” on each dollar taxpayers “invest” in state/local pension plans?
- Because employee contributions and investment earnings finance most of the benefits, this factor is large...



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Conclusions

- State and local pension plans have a large economic footprint in the U.S. and Alaska.
- State and local pensions have significant ripple effects – one retiree’s spending becomes someone else’s income.
- State and local pensions have sizable multipliers – up-front investment of taxpayer dollar goes a long way.



Conclusions

- State and local pensions do more than provide a critical source of reliable income for 7.3 million retired Americans and 35,000 retired Alaskans.
- They support 2.5 million American jobs and \$358 billion in national economic activity.
- They support 6,270 Alaskan jobs and \$1 billion in economic activity.
- Pensions are “automatic stabilizers” – retirees can continue to spend on basic needs, providing important stimulus during these tough times.



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ALASKA STATE LEGISLATURE

Senator Joe Paskvan

Chair, Labor and Commerce
Vice Chair, Health and Social Services
Member, Transportation
Member, State Affairs
Member, Joint Armed Services



Senate District E
Fairbanks and Fort Wainwright

State Capitol Building, Room 7
Juneau, Alaska 99801-1182

Phone (907) 465-3709
Fax (907) 465-4714
sen.joe.paskvan@legis.state.ak.us
<http://paskvan.aksenate.org/>

To: Senator Linda Menard, Chair
Senate State Affairs Committee

From: Senator Joe Paskvan

A handwritten signature in blue ink that reads "Joe Paskvan".

Date: Friday, March 20, 2009

Re: SB 23 and National Institute on Retirement Security

Thank you for scheduling SB 23 for a hearing in State Affairs on Tuesday, March 24, and allowing Beth Almeida, Executive Director, National Institute on Retirement Security (NIRS), to present expert testimony.

Ms. Almeida's presentation will focus on two NIRS reports: (1) *Pensionomics: Measuring the Economic Impact of State and Local Pension Plans* with data specific to Alaska and (2) *A Better Bang for the Buck: The Economic Efficiencies of Defined Benefit Pension Plans*.

Please find the attached documents from the National Institute on Retirement Security, including the two mentioned above, that present the research of the institute:

- **Press release** (February 26, 2009): *New Study Finds 6,270 Jobs, \$1 Billion Economic Impact From Alaska's Public Pension System*;
- **Key Findings:** *Pensionomics: Measuring the Economic Impact of State and Local Pensions*;
- **Fact Sheet:** *A Better Bang for the Buck: The Economic Efficiencies of Defined Pension Plans*;
- **Frequently Asked Questions:** *A Better Bang for the Buck: The Economic Efficiencies of Defined Pension Plans*;
- **Issue Brief:** *Retirement Readiness: What Difference Does A Pension Make?*;
- **Issue Brief:** *Patience Is A Virtue: Asset Allocation Patterns in DB and DC Plans*;
- **Issue Brief:** *Look Before You Leap: The Unintended Consequences of Pension Freezes*;
- **At-A-Glance:** National Institute on Retirement Security.

Each of these documents can be found at www.nirsonline.org.

I look forward to discussing the merits of SB 23 on Tuesday and, again, thank you for your consideration. Please let me know if you have any questions or comments.



NATIONAL INSTITUTE ON
Retirement Security
Research • Education • Advocacy

NEWS Release

Contact: Kelly Kenneally
202.457.8190
kkenneally@nirsonline.org

NEW STUDY FINDS 6,270 JOBS, \$1 BILLION ECONOMIC IMPACT FROM ALASKA'S PUBLIC PENSION SYSTEMS

Analysis Determines Pensions Leave Substantial Economic Footprint

WASHINGTON, D.C., FEBRUARY 26, 2009 – An economic impact analysis released today finds that the benefits provided by Alaska's public pension plans have a sizable impact that ripples across the state and touches every industry. The new report, "*Pensionomics: Measuring the Economic Impact of State and Local Pension Plans*," finds that expenditures made from Alaska's public pension benefits for fiscal year 2005-2006:

- Had a total economic impact of more than \$1 billion.
- Supported more than 6,270 jobs that paid more than \$385.2 million in total compensation to Alaska's workers.
- Supported more than \$155.5 million in annual federal, state, local tax revenue.
- Paid \$819.5 million in pension benefits to 34,962 retirees and beneficiaries.
- Had large multiplier effects. Each taxpayer dollar invested in Alaska's public pensions supported \$1.25 in total economic activity, while each dollar paid out in benefits supported \$6.35 in economic activity.
- Impacted every industry in the state.

A detailed Alaska economic impact Fact Sheet is available at www.nirsonline.org. The report also analyzes the national economic impact of public pensions to find 2.5 million jobs and \$358 billion in economic activity supported by state and local pensions.

"This study measures the magnitude of the 'multiplier effect' of Alaska's public pensions across the state's economy," said Ilana Boivie, NIRS policy analyst and report co-author. "The multiplier effect occurs because one retiree's spending in Alaska becomes another person's income," she said.

Boivie explained, "For example, a retired Alaska teacher may spend his or her pension check to pay the gas bill, buy a car, or make purchases at the local pharmacy, grocery store, or movie theatre. As a result of the retiree's spending, businesses see an increase in their income, which then enables businesses to spend and create jobs. Each successive round of spending ripples through the Alaska economy to generate an economic impact that is much larger than the initial spending by the retiree."

--more--

"Understanding the considerable economic impact of Alaska's public pensions is vital given the severe financial crisis facing America," said Beth Almeida, NIRS executive director and report co-author. "Economists have long known that the steady monthly income provided by pensions can act as an 'automatic stabilizer.' That is, retirees with a stable monthly pension income can continue to spend on basic needs, even during an economic downturn. In contrast, retirees relying solely on plummeting 401(k)s or individual retirement accounts likely are forced to retreat from spending precisely at the time when the Alaska economy most needs stimulus," Almeida explained.

The analysis was conducted using data from the U.S. Census Bureau and IMPLAN, an input-output modeling software widely used by industry and governments.

NIRS will hold a conference call regarding the findings on Thursday, February 26, 2009 at 11 AM ET by dialing (800) 230-1074, Confirmation Number: 988166.

A live PowerPoint presentation will be available online during the conference call. Log on to the web conference by visiting www.gotomeeting.com. On the left hand column of the page, click "Join Meeting." When prompted, enter Meeting Number 193-429-659. Enter the requested information to access the presentation.

The Report, State Fact Sheets, and PowerPoint Presentation will be available in advance of the call at www.nirsonline.org on Feb. 26th at 9 AM ET.

An audio digitized replay of the call will be available from February 26, 2009 at 1 PM ET through March 26, 2009 at 11:59 PM ET by dialing (800) 475-6701, Access Code 988166.

ABOUT NIRS

NIRS is a non-profit, non-partisan organization established to contribute to informed policymaking by fostering a deep understanding of the value of retirement security to employees, employers, and the economy as a whole. Located in Washington, D.C., NIRS's membership includes employee benefit plans, agencies that manage retirement plans, trade associations, financial services firms, and other retirement service providers.

###

ALASKA

Pensionomics:

Measuring the Economic Impact of State and Local Pension Plans

Key Findings

Benefits paid by state and local pension plans support a significant amount of economic activity in the state of Alaska.

Pension benefits received by retirees are spent in the local community. This spending ripples through the economy, as one person's spending becomes another person's income, creating a *multiplier effect*.

Expenditures stemming from state and local pensions supported...

- 6,270 jobs that paid \$385.2 million in wages and salaries
- \$1.0 billion in total economic output
- \$155.5 million in federal, state, and local tax revenues

... in the state of Alaska

Each dollar paid out in pension benefits supported \$1.25 in total economic activity in Alaska.

Each dollar "invested" by Alaska taxpayers in these plans supported \$6.35 in total economic activity in the state.

Overview

Expenditures made by retirees of state and local government provide a steady economic stimulus to Alaska communities and the state economy. In 2006, 34,962 residents of Alaska received a total of \$819.50 million in pension benefits from state and local pension plans, with \$808.64 million paid from plans within the state and the remainder originating from plans in other states.

The average pension benefit received was \$1,953 per month or \$23,440 per year. These modest benefits provide retired teachers, public safety personnel and others who served the public during their working careers income to meet basic needs in retirement.

Impact on Jobs and Incomes

Retiree expenditures stemming from state and local pension plan benefits supported 6,270 jobs in the state. The total income to state residents supported by pension expenditures was \$385.2 million.

Of this, the greatest share, \$188.0 million, was comprised of employee compensation (wages and salaries). Proprietors' income (self-employment income) represented \$33.6 million, and other property income (including payments from interest, rent, royalties, profits and dividends) totaled \$163.6 million.

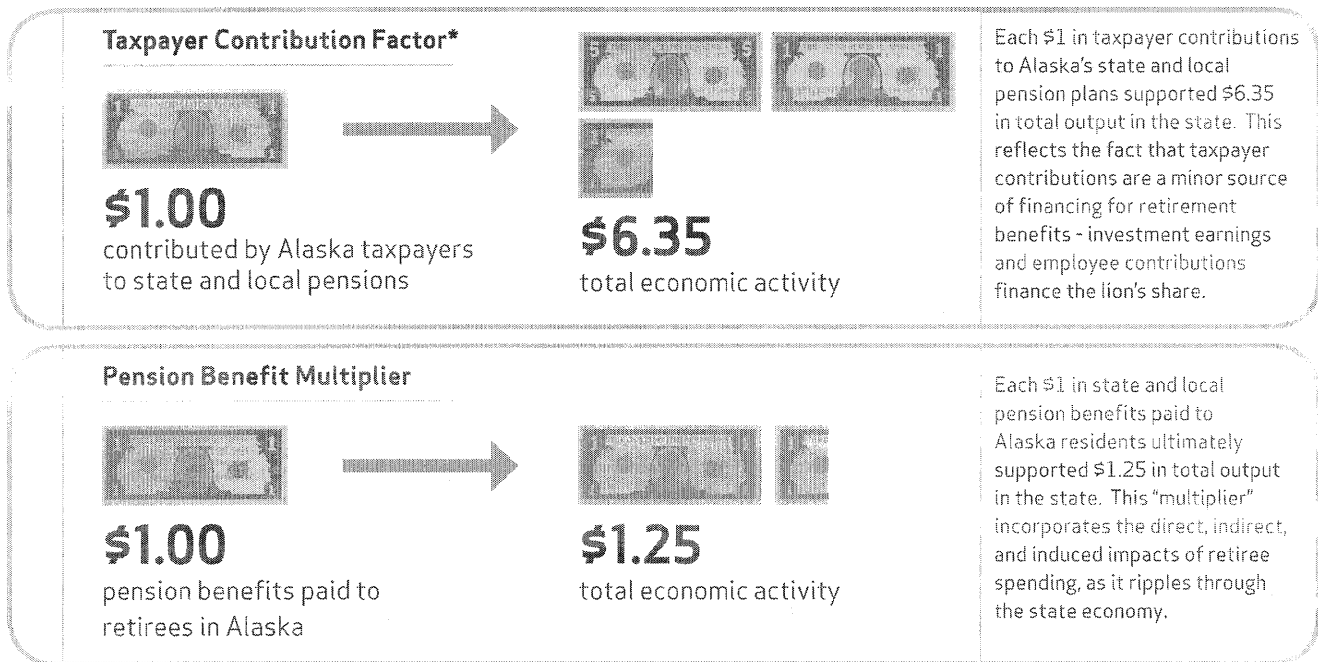
Economic Impact

State and local pension funds in Alaska and other states paid a total of \$819.50 million in benefits to Alaska residents in 2006. Retirees' expenditures from these benefits supported a total of \$1.0 billion in total economic output in the state, and \$430.7 million in value added in the state.

\$790.8 million in direct economic impacts were supported by retirees' expenditures on goods and services from businesses in the state. An additional \$120.4 million in indirect economic impact resulted when these businesses purchased additional goods and services, generating additional income in the local economy. \$112.8 million in induced impacts occurred when employees hired by businesses as a result of the direct and indirect impacts made expenditures, supporting even more additional income.



Economic Multipliers



* Caution should be used in interpreting this number, because the Census data used reflect the taxable status of contributions only; because employee contributions may be reported as taxpayer contributions, the multiplier here may be underestimated.

Impact on Tax Revenues

State and local pension payments made to Alaska residents supported a total of \$155.5 million in revenue to federal, state and local governments. Taxes paid by retirees and beneficiaries directly out of pension payments totaled \$28.7 million. Taxes attributable to direct, indirect and induced expenditures accounted for \$126.8 million in tax revenue.

Federal Tax	87.5 million
State/Local Tax	67.8 million
Other Corporate Taxes	0.2 million
Total	\$155.5 million

Economic Impacts by Industry Sector

The economic impact of state and local pension benefits was broadly felt across various industry sectors in the state. The ten industry sectors with the largest employment impacts are presented in the table below.

Industry	Employment Impact (# Jobs)	Value Added Impact (\$ millions)	Income Impact (\$ millions)	Output Impact (\$ millions)
Health Care and Social Assistance	1,354	\$75.0	\$74.2	\$119.1
Retail Trade	1,331	64.4	50.9	97.0
Accommodation and Food Services	839	26.7	23.8	50.0
Other Services (Except Public Administration)	479	14.2	13.3	27.1
Real Estate and Rental and Leasing	452	33.8	28.2	50.8
Professional, Scientific, and Technical Services	229	11.8	11.5	23.2
Arts, Entertainment, and Recreation	229	6.2	5.6	10.8
Finance and Insurance	227	24.2	23.3	43.9
Public Administration	196	10.1	10.1	20.7
Transportation and Warehousing	187	11.4	10.8	22.0

FACT Sheet



A Better Bang for the Buck The Economic Efficiencies of Defined Benefit Pension Plans

Overview

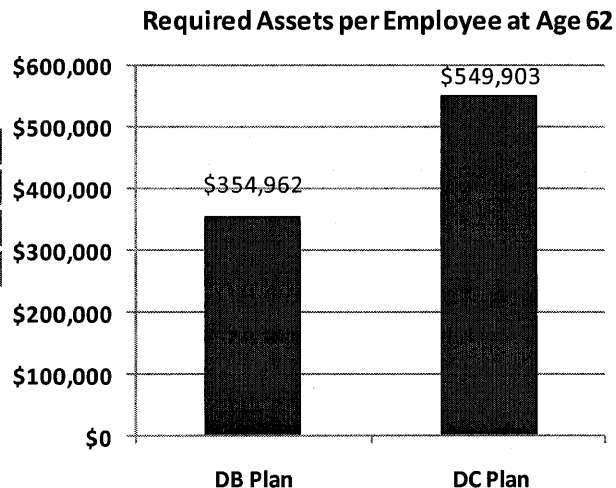
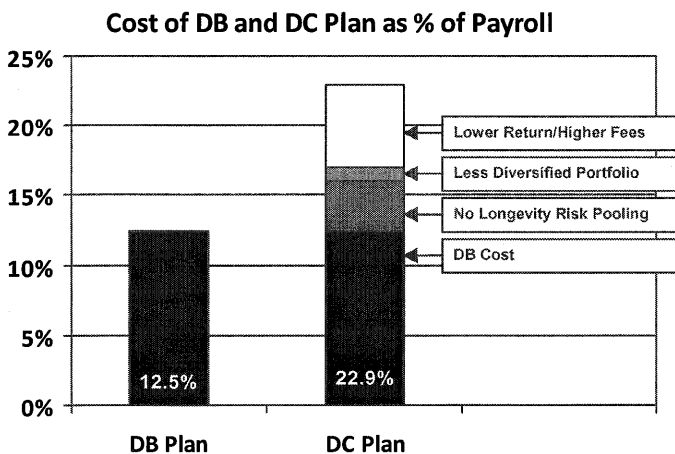
The National Institute on Retirement Security has released a new report, "A Better Bang for the Buck: The Economic Efficiencies of Defined Benefit Pension Plans." The report presents an original analysis on the efficiencies of defined benefit pension (DB) plans, and the costs of DB plans as compared to 401(k)-type individual defined contribution (DC) plans.

The report's analysis and findings serve as a myth buster with respect to the costs of defined benefit pension plans. Specifically, the embedded **economic efficiencies of DB plans make them nearly half the cost of DC plans, or a 46 percent cost savings.**

Policy and decision makers can utilize these findings to make informed decisions about retirement security issues and to evaluate claims that DC plans save money. The report concludes that DB plans should remain a centerpiece of retirement income policy and practice, especially in light of current fiscal and economic constraints facing corporate and government retirement plan sponsors.

Methodology

The model makes an "apples to apples" calculation of the actual dollar contributions required for a DB and DC plan to achieve the same target retirement benefit. The target retirement benefit in the model is \$26,684. Together with Social Security benefits, this retirement benefit allows a retiree to replace 83% of pre-retirement income, which meets generally accepted standards of retirement income adequacy.



Key Findings

The DB plan provides the best bang for the retirement buck. Under the model, the DB plan provides the same retirement income at nearly **half the cost - 46 % less** than individual 401(k)-type DC accounts.

Under the DB plan, contributions of 12.5% of payroll each year are required to fund the target retirement benefit. The DB plan will need to have \$355,000 set aside for each participant by the time the worker turns 62. In contrast, the DC plan requires contributions of 22.9% of payroll each year. The less-efficient DC plan will need to have \$550,000 set aside for each participant in the plan by the time the worker turns 62. In other words, the DB plan can provide the same benefit at a cost that is 46% lower than the DC plan. **The DB plan can do more with less providing the same benefit for nearly \$200,000 less per participant.**

Economic Efficiencies Are Embedded in DB Plans

DB plans have certain embedded characteristics that drive their economic efficiencies:

1. **DB Plans Avoid “Over-Saving.”** We won’t all live to be ninety-five or one hundred. But in an individual plan, many of us will want to save enough to last until very old age to avoid the risk of running out of money. However, a DB plan only has to save for the AVERAGE life expectancy, which is much lower and which actuaries can calculate with a high degree of accuracy. By saving for a realistic average life expectancy, the DB plan realizes a **15% cost savings** over the DC plan. In technical terms, this is called “longevity risk pooling.”
2. **DB Plans Stay Forever Young.** Individuals age. Therefore, those in individual retirement plans must adjust their asset allocation to ensure sufficient cash is on hand to last throughout retirement. Most financial advisors counsel downshifting from higher risk/higher return investments to lower risk/lower return investments as they get older. This protects individuals from the risk of a stock market crash, but progressively reduces the investment returns that can be earned in retirement piggybanks. However, a DB plan exists across generations and therefore can always maintain the most optimal asset allocation. There isn’t a need to be overly weighted in lower return/risk bonds or cash. This results in a **5% cost savings** over the DC plan.
3. **DB Plans Achieve Higher Investment Returns.** The higher returns of DB plans as compared to individual accounts can be attributed a combination of professional asset management and lower fees. A retirement plan that earns greater investment returns will require less money in contributions. Even seemingly small differences in annual returns compound over time. In our model, a 1% difference in annual investment returns results in a **26% cost savings** over a career, as compared to the DC plan.

Summary

“A Better Bang for the Buck: The Economic Efficiencies of Defined Benefit Pension Plans,” makes it clear that the embedded economic efficiencies of DB plans enable them to deliver the **same benefit at nearly half the cost of DC plans, or a 46 percent cost savings**. While the efficiencies of DB plans are well documented, this report is important in terms of quantifying the magnitude of those efficiencies.

The report’s findings also serve as a myth buster to conventional wisdom with respect to the fiscal efficiencies and costs of DB pension plans. In fact, **DB plans are the most fiscally efficient means of providing a modest but stable retirement income that cannot be outlived**. DC plans are important to the retirement security equation, but they were not designed to stand on their own.

Policy and decision makers can utilize this data to make informed decisions about retirement security issues and to evaluate claims that DC plans save money. The report concludes that DB plans should remain a centerpiece of retirement income policy and practice, especially in light of current fiscal and economic constraints facing corporate and government retirement plan sponsors.

FAQ



NATIONAL INSTITUTE ON
Retirement Security

Reliable Research. Sensible Solutions.

A Better Bang for the Buck The Economic Efficiencies of Defined Benefit Pension Plans

Why this report?

For a number of reasons, retirement security has been at the forefront of policy discussions and media attention. Millions of baby boomers are approaching retirement with inadequate retirement assets. At the same time, home values have plummeted, the market/401(k) accounts have taken a nosedive, and consumer prices and inflation have skyrocketed.

Unfortunately, inaccurate and incomplete information about defined benefit (DB) retirement plans has colored retirement policy discussions. In particular, claims have been made that 401(k)-type individual defined contribution (DC) plans are less expensive than DB plans.

“A Better Bang for the Buck: The Economic Efficiencies of Defined Benefit Pension Plans” was published to assess the embedded economic efficiencies of DB plans and then make an “apples-to-apples” calculation of the actual dollar contributions required for a DB and DC plan to achieve the same target retirement benefit.

The report is a myth buster. The findings indicate that a DB pension plan can deliver the same level of retirement income to a group of employees at nearly half the cost – 46% lower – than a DC account.

How was the study conducted?

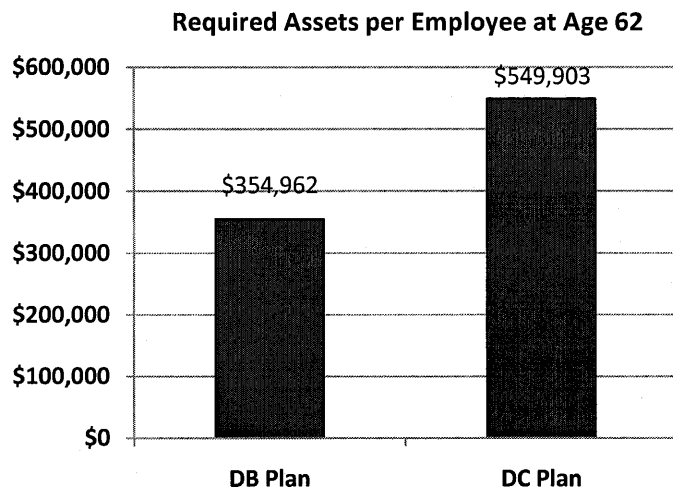
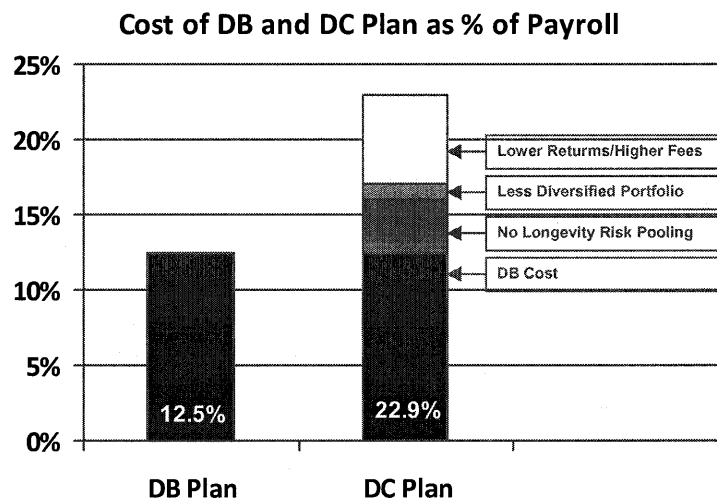
In “Bang for the Buck,” we developed a model that makes an “apples to apples” calculation of the actual dollar contributions required for a DB and DC plan to achieve the same target retirement benefit.

The model is based on a group of 1,000 newly hired 30 year old female teachers who work for a total of 30 years and retire at age 62 with a final salary of \$50,000. The target annual pension benefit for the model is \$26,684 annually, or \$2,224 monthly with cost of living adjustments. Together with Social Security benefits, each teacher in the model can expect to receive roughly 83% of her pre-retirement income, which meets the accepted standards of retirement income adequacy.

What are the key findings?

The DB plan provides a better bang for the retirement buck. Under the model, the DB plan provides the same retirement income at nearly half the cost of individual 401(k)-type defined contribution accounts - specifically, a 46% lower cost.

The DB plan needs contributions of 12.5% of payroll each year in order to reach the target benefit level. It needs to set aside \$355,000 for each worker by the time she turns 62. In contrast, the DC plan requires contributions of 22.9% of payroll each year. It needs to set aside \$550,000 for each participant in the plan by the time she turns 62. In other words, the DB plan can provide the same benefit at a cost that is 46% lower than the DC plan, \$200,000 less per participant.



How is it that DB plans are less expensive than DC plans?

There are three characteristics embedded in DB plans that drive their economic efficiency:

1. **DB Plans Avoid “Over-Saving.”** We won’t all live to be ninety-five or one hundred. But in an individual plan, many of us will want to save enough to last until very old age to avoid the risk of running out of money. By contrast, a DB plan only has to save for the AVERAGE life expectancy, which is much lower and which actuaries can calculate with a high degree of accuracy. By saving for a realistic average life expectancy, the DB plan realizes a **15% cost savings**. In technical terms, this is called “longevity risk pooling.”
2. **DB Plans Stay Forever Young.** Individuals age. Therefore, those of us in individual retirement plans must adjust our asset allocation to ensure sufficient cash is on hand throughout retirement. Most advisors counsel individuals to downshift from higher risk/higher return investments to lower risk/lower return investments as they get older. This process protects us from the risk of a stock market crash, but progressively reduces the investment returns we can expect to earn in our retirement piggybanks. However, a DB plan exists across generations and can always maintain the most optimal asset allocation. There isn’t a need to be overly weighted in bonds or cash. This results in a **5% cost savings**.
3. **DB Plans Achieve Higher Investment Returns.** The higher returns of DB plans as compared to individual accounts can be attributed a combination of professional asset management and lower fees. A retirement plan that earns greater investment returns will require less money in contributions. Even seemingly small differences in annual returns compound over time. In our model, a 1% difference in annual investment returns results in a **26% cost savings** over a career, as compared to the DC plan.

How much cheaper are DB plans?

By our calculations, delivering the same retirement benefit is 46 percent less expensive with a DB plan than a DC plan.

In our model, the DB plan can pay for the teachers target retirement income with contributions of just 12.5% of payroll each year, while the DC plan costs 22.9% of payroll each year. In terms of the dollars that must be accumulated, the DB plan can provide the target retirement income with \$355,000 set aside for each teacher by the time each turns 62. In contrast, the DC plan must accumulate \$550,000 per teacher in the plan by the time she turns 62. The DB plan can provide the same retirement benefits even as it accumulates nearly \$200,000 less per participant.

So, why the trend of switching from DB to DC plans?

There is a good deal of confusion about the relative costs and economic efficiencies of DB plans versus DC plans.

While many employers have cited the financial burden of DB plans as their main reason for shifting from a DB to a DC plan, it is important to separate the question of benefit generosity from the question of the economic efficiency of a retirement plan. Our model separates these issues by constructing an apples-to-apples comparison using the same target retirement benefit.

A review of the economic literature also helps in this regard. Researchers have found that when employers move out of DB and into DC plans, they almost always cut the average employee benefit in the process. One study found that between 1981 and 1998 the average employer pension contribution declined from \$2,140 to \$1,404 per employee, while the share of pension contributions attributed to DC plans increased from 23% to 68% in that time period.

Thus, when employers simultaneously reduce their contributions along with the move from DB to DC, they will undoubtedly save money. This does not mean, however, that DC plans are inherently cheaper than DB plans. It simply means that employers are reducing employee benefits while also changing the benefit design. Shifting costs from one party (the employer who reduces contributions) to another (employees who receive less in retirement) does not reduce costs overall.

What are the elements of a secure retirement?

NIRS, along with most retirement experts, believes that retirement security can be achieved with a “three-legged stool” consisting of Social Security, a DB plan, and a supplemental DC savings plan. Workers who have access to all three sources of retirement income are in the best position to achieve a secure retirement.

Although the report indicates that retirement benefits in DC plans are nearly twice the price, the report also indicates that DC plans are essential to the retirement security equation. DC plans enable workers the save for retirement in a manner that reflects their individual situations.

At the same time, there is a dire need to rebuild retirement readiness. This must involve ensuring DB plans remain the centerpiece of retirement income policy and practice. Given current fiscal and economic constraints facing corporate and government retirement plan sponsors, the bang for the buck provided by DB plans is all the more important.

Is there a way to create a “pension renaissance?”

Reviving the pension system for the private sector is imperative in ensuring the nation moves forward and not backward.

Right now, we're on the backward track. Retirement plan coverage is declining, and personal savings are virtually non-existent. Unless we can turn around and leverage the economic and fiscal efficiencies of DB plans, we are doomed to a nation of underfunded individual retirement plans. In the end, Americans will turn to expensive public entitlement programs in their old age or work until they die. Neither option is palatable.

We hope that research such as the Bang for the Buck will provide policy and decision makers with factual data to improve retirement policies and decisions. A pension renaissance can occur by leveraging pension systems that work (such as multi-employer and public pensions) and identifying ways to revive private sector plans.

Who authored and sponsored the report?

The report is published by the National Institute on Retirement Security, a new not-for-profit organization in Washington, DC. NIRS is dedicated to research and education programs that deliver reliable research and sensible solutions related to retirement security matters.

The report authors are Beth Almeida, NIRS Executive Director, and William (Flick) Fornia, Aon Consulting Senior Vice President. Almeida is an economist and was involved with the transition of some 40,000 airline employees out of terminating or freezing pensions into a multi-employer defined benefit pension plan. Fornia is an actuary with nearly 30 years of pension and healthcare experience in the public and private sectors.

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NATIONAL INSTITUTE ON
Retirement Security
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Retirement Readiness
What Difference Does A Pension Make?
By Beth Almeida

Introduction

An adequate retirement income can be defined as one that enables an older household to take care of its own needs in retirement. Workers who retire without adequate sources of income may face a range of unattractive choices. Continuing to work may be the first alternative, but if that is not an option due to bad health, lack of appropriate job opportunities or other factors, retirees may become dependent on family or even public assistance programs to meet financial needs.

Most Americans prefer to be able to meet their own needs after they stop working, so the question of how employees achieve retirement income adequacy is a pressing one, not just for individuals' well-being, but for public policy as well. It is probably not surprising that job-based retirement plans make a difference, but the particular importance of traditional pensions, so-called defined benefit (DB) pensions, in ensuring retirement readiness may be underappreciated. DB pensions really do make a difference for working Americans in achieving an adequate standard of living in retirement as a reward for decades of hard work.

This brief reviews the evidence on the role DB pensions play in ensuring that older Americans have the resources they need to be self-sufficient in retirement.

It examines recent trends in pension coverage and discusses the effect these trends have had on the state of retirement readiness

among American workers. Finally, it points in the direction of areas worthy of exploration for policymakers seeking to address specific retirement security goals.

People with pensions are less likely to be at risk in retirement

The desire to remain independent in old age is virtually universal.

The notion that retirees should have the means to be self-sufficient in retirement was a bedrock value on which our nation's decades-long commitment to Social Security was built. While it is well-recognized that Social Security is highly effective at lifting retirees and their families out of poverty, it is also true that this safety net was not designed to enable retirees to maintain their pre-retirement living standards on its own.

Employment-based retirement plans are the key way that middle class workers remain part of the middle class after they stop working. Indeed for retirees with incomes between \$16,000 and \$44,000 per year, income from employment-based retirement plans represents the most significant source of income, after Social Security (Table 1).

The Social Security statistics do not distinguish between income provided by a DB pension and that deriving from defined contribution (DC) retirement savings plans, such as 401(k)s and IRAs. But there is reason to believe that DB pensions, distinct from DC plans, play an especially important role in supporting retirement income adequacy.

**Table 1 Sources of Income Among Households Aged 65 and Older, 2004
Percent Distribution by Source**

	Household Income				
	1 st quintile	2 nd quintile	3 rd quintile	4 th quintile	5 th quintile
	Up to \$10,399	\$10,400 to \$16,363	\$16,364 to \$25,587	\$25,588 to \$44,129	\$44,130 and up
Percentage of income from...					
Social Security/Railroad Retirement	82.9%	83.8%	67.2%	48.5%	19.2%
Employment-based Retirement Plans	3.2%	6.6%	16.0%	24.7%	20.9%
Earnings	1.2%	2.8%	7.1%	15.7%	40.1%
Income from assets	2.3%	3.8%	6%	8.4%	17.8%
Public assistance	8.4%	1.6%	0.9%	0.2%	0.1%
Other	<u>2.0%</u>	<u>1.5%</u>	<u>2.7%</u>	<u>2.6%</u>	<u>1.9%</u>
All income sources	100%	100%	100%	100%	100%

Source: Social Security Administration, 2006

Studies of retirement preparedness typically begin by examining the financial resources that will be available to households when they retire. Such resources may include DB pension benefits, Social Security benefits, and savings accumulated in DC plans and elsewhere. Some studies take an even broader measure, including earnings from work by “retired” individuals, the value of welfare benefits, and the value of home equity, as assets that can be tapped to generate income in retirement.

To gauge retirement readiness, researchers compare the aggregate level of such resources for individual households to some standard. Some researchers rely on a relative standard, like the proportion of pre-retirement income that can be replaced in retirement (replacement rates). An “adequate” replacement rate is typically defined as one that allows a retired household to enjoy roughly the same standard of living as it did before retirement. This standard of adequacy might be deemed to fall anywhere from 65% to 85% of pre-retirement income.¹ Other researchers have used an absolute standard, like the poverty threshold. Obviously, this

¹ A replacement rate less than 100% may adequately allow a household to maintain its pre-retirement standard of living, because some expenses decline in retirement (e.g. payroll taxes, commuting costs and other job-related expenses, and the cost of saving for retirement).

approach encompasses a narrower definition of “needs” in retirement. Using either standard, DB pensions appear to play a special role in ensuring retirement preparedness.

Researchers at Boston College find that those with DB pensions are much more likely to maintain their pre-retirement living standard and thus are less likely to be at risk of inadequate retirement income than those who rely on DC plans or who have no retirement plan to rely on. (Munnell et al 2007 and 2008) Predictably, those with both a DB pension and a DC plan are the least likely to be at risk of having income that falls short. The study labels “at risk” households that are projected to fall more than 10% short of achieving a target replacement rate designed to maintain pre-retirement living standards.

For households approaching retirement today, about one in three are at risk of falling short. But among those with a DB pension plan, just 15% are “at risk” and just 12% of those that can count on both a DB pension and a DC plan are “at risk.” Fully half of households approaching retirement that do not have any type of retirement plan are deemed “at risk.” The risk-reducing effects of DB pension plans are consistent across age groups – from the Early Baby Boomers through Generation X (Table 2).

Table 2 Percent of Households “At Risk” at Age 65 by Birth Cohort and Retirement Plan Coverage

Retirement Plan Coverage	Early Boomers Born 1946-1954	Late Boomers Born 1955-1964	Generation X'ers Born 1965-1972
All households	35%	44%	49%
Households with both DB pension & DC plan	12%	21%	25%
Households with a DB pension plan	15%	20%	30%
Households with a DC plan	49%	52%	48%
Households with no retirement plan	50%	60%	65%

Source: Munnell et al 2007

Likewise, a 2007 Federal Reserve study finds that DB pension plans are highly effective at ensuring that retirees have sufficient resources to support themselves. (Love et al 2007) This study uses an absolute standard of retirement income adequacy (i.e. the poverty line or “near-poverty,” defined as 1.5 times the poverty line). It finds that fully 96% of households that can count on receiving DB pension benefits will have sufficient income to exceed the poverty line.² 83% of DB pension recipients will have income in excess of 1.5 times the poverty line. Households that rely on DC plans face higher risks of hardship than those with DB pensions. 10% of DC plan households will have income below the poverty line and 26% will be either poor or near-poor, with income below 1.5 times the poverty line.

Considering that only four in ten household in the Federal Reserve study have DB pensions, whereas about half have DC plans, the stronger poverty-reducing impact of DB pension plans may be surprising. However, it

² It is well recognized that the official “poverty line” is a problematic and somewhat arbitrary standard. The “poverty line” is based on a measurement developed in 1964 that fails to accurately account for dramatic changes since that time in the costs of health care, housing, and other items. For this reason, researchers will often use a threshold of 1.5 times the poverty line as a better measure of income adequacy. This is supported by research in the field of gerontology which indicates that elder households may need income of 1.5 to 3.0 times the poverty line in order to meet even the most basic needs. (Russell Bruce and Conahan 2006)

is less surprising when one takes into account the fact that the median wealth held in a DB pension plan is about two times larger than the median holdings in DC plans and IRAs.³ This indicates that DB pension plans tend to be better at ensuring employees are able to accumulate adequate resources for retirement.

Features of DB pensions enhance retirement income adequacy

What is it about DB pensions that makes them so effective at ensuring retirement income adequacy, as compared with DC plans? Certainly, DB plans share common features with DC plans. For instance, they both are employment-based plans that make preparing for retirement easier than if employees had to tackle the job completely on their own. Both DB pensions and DC plans benefit from tax incentives designed to encourage retirement preparedness. Both types of plans are governed by laws designed to protect employees and their benefits. But there are certain features that are distinctive to DB pensions that seem to make a significant impact on retirement readiness.

³ Although DB pensions typically pay a regular income for life, researchers typically translate this expected stream of income into a stock of wealth to make the benefit comparable to retirement savings accounts, such as 401(k) plans. In essence, researchers calculate the amount of savings today that would, together with interest, pay the same regular income stream in the future.

DB pensions provide broad-based coverage. In other words, if an employee meets the eligibility requirements of the plan, she is automatically included in the plan and will earn benefits without having to actively make any decisions. By contrast, DC plans often require an employee to enroll, make decisions about how much to save, and direct their own investments.

Research tells us that despite employees' best efforts, workers generally fail to save enough, make poor asset allocation and investment decisions, and are reluctant to purchase annuities with the retirement wealth they do manage to accumulate – even when doing so could enhance their well-being. (Benartzi and Thaler 2007; Mitchell and Utkus 2004; Munnell and Sunden 2004) Simply put, research suggests that the average worker is not cut out for a “do-it-yourself” retirement plan.

Recent changes in DC plan regulations under the Pension Protection Act of 2006 have made employers more willing to set up “default” participation and investment rules in their DC plans, whereby even if the employee makes no affirmative decisions, he will be automatically enrolled in the plan and his savings will be directed to a default investment. The hope is, this will improve the outcomes for participants in DC plans, but it is far too soon to reach any conclusions and in light of the poor state of Americans' retirement readiness, the stakes are high.

DB pensions provide secure money for retirement. Just as important as what DB pensions do is what they do not do. Generally, the inability of individuals to tap funds in their DB pensions (either via a withdrawal or loan) means that money set aside for retirement is more likely to actually be used for its intended purpose. This is an important distinction from 401(k) plans, 87.5% of which permit participants to borrow from their retirement accounts. (PSCA 2007) Likewise, individuals can withdraw assets from 401(k) plans and IRAs before retirement age. According to one conservative estimate, some 10% of retirement wealth is lost because of this “leakage” of money from DC plans. (Englehart 1999)

DB pensions provide professional asset management. Because assets in DB pension plans are pooled together and managed by professionals, it should not be surprising that DB pension plans tend to achieve better investment returns than individuals. According to one estimate, the gap is huge – over an eight-year period, DB pension plans outperformed DC plans by an average of 1.8% per year. The impact of such under-performance over a career is staggering. At the end of 25 years, the effect of a 1.8% difference in annual return translates to a reduction in the size of an individual's savings by 34%. (Flynn and Lum 2007) Expressing this in dollar terms, a 34% reduction would shrink a \$150,000 nest egg to a much smaller \$99,000.⁴

DB pensions provide a lifetime income. A predictable income that cannot be outlived is an essential element of retirement security. Private sector DB pensions are required by the Employee Retirement Income Security Act (ERISA) to offer annuity benefits – that is a series of monthly payments that last a lifetime – as the standard form of payment. DB pension plans offered by federal, state and local governments also pay annuity benefits, even though they are not required by ERISA to do so.

The availability of an annuity benefit means that retirees with income from a DB pension have an easier time budgeting for their regular expenses, because the size of their pension check does not fluctuate with interest rates or the stock market. As will be discussed in greater detail, older Americans appear to be having a difficult time spending down their retirement savings in DC plans in an optimal way. This indicates that the predictable, monthly, lifetime benefit provided by DB pensions has great value that may be underappreciated. Indeed, retirees tend to be happier and report greater levels of satisfaction when they have a predictable, guaranteed source of retirement income like a DB pension or annuity, on top of Social Security. (Panis 2004; Sondergeld et al 2002; Metlife 2002)

⁴ With \$150,000 in a DC plan at retirement at age 65, an individual could purchase an annuity that would pay about \$865 per month, every month, for life, with protections for a surviving spouse. A \$99,000 nest egg would provide an income of only about \$570 per month.

DB pensions provide special protections for spouses. Beyond the basic requirement to offer a lifetime stream of income, ERISA goes a step further in providing special protections for spouses of married beneficiaries. The law requires that the standard benefit form for married participants is an annuity that continues paying a benefit to a spouse, even after the death of the employee/retiree. The right to receive benefits in this form can be waived, but only by the spouse. Federal, state and local government DB pension plans typically provide similar spousal benefits. Considering their longer life expectancy, spousal protections are especially important to women's economic security in retirement. (Shaw and Hill 2001)

Recent trends in DB pension coverage raise concern

In recent years, many employers in the private sector have shifted away from offering DB pensions in favor of DC plans. Evidence indicates that this shift has not only been one of form, but one of substance as well. Specifically, the shift has involved a reduction in the amount of money being set aside for retirement, leading to a reduction in retirement wealth for the typical worker.

Chilarducci and Wei (2006) find that the shift from DB pensions to DC plans was associated with a reduction in employer spending on retirement plans. Specifically, they find that a 10% increase in the use of DC plans reduces employer retirement plan costs per worker by 1.7-3.5%. This suggests firms have used DC plans to reduce retirement plan expenditures, meaning fewer dollars being directed by employers into retirement plans.

Unfortunately, it does not appear that employees are digging deeper into their household budgets to save more in response to employers' reduced contributions to retirement plans. Instead, the shift from DB pensions to DC plans appears to be having a negative effect on the typical household's retirement readiness.

Sorokina et al (2008) find that retirement wealth for households approaching retirement actually fell between 1992 and 2004, a period that saw DB pension coverage drop and the proportion of the workforce

covered by DC plans surge. In 1992, about three-fourths of those with a retirement plan at work were covered by a DB pension plan, or a combination of a DB pension plan *and* a supplemental DC plan. By 2004, this proportion had fallen to 57%.

The authors find that the shift from DB pensions to DC plans was accompanied by a significant reduction in total retirement wealth. Although the average household's DC wealth grew from about \$35,000 in 1992 to about \$48,000 in 2004, DB pension wealth for the average household declined from over \$92,000 in 1992 to just over \$65,000 in 2004. Thus, total retirement wealth declined from about \$127,000 to roughly \$113,800 - an 11% drop.

Many Americans will fall short in retirement without DB pensions

Plenty of evidence suggests that recent trends in DB pension coverage will leave large numbers of American families under-prepared for retirement, with insufficient resources to meet their needs.

The afore-mentioned Boston College studies find that between 44% and 61% of households are at risk of being unable to maintain their living standards in retirement, even if they work to age 65, plan to consume all their financial assets, and take out reverse mortgages to "monetize" their housing wealth. (Munnell et al 2007 and 2008)

The Federal Reserve study cited earlier finds that 12% of Americans currently aged 51 and older will fall below the poverty line, and that another 9% will be "near poor" even after accounting for receipt of public assistance, wages from work, and the consumption of all wealth (including housing wealth) over one's expected lifetime. (Love et al 2007) That two in five elder households will struggle financially, even after taking into account the receipt of public assistance, is certainly cause for concern.

The findings of these two studies are even more alarming in light of the fact that most households do not or cannot effectively "monetize" their housing wealth. Despite the increasing awareness and availability of reverse mortgages that could allow older

Americans to convert their home equity into cash that can be spent to meet retirement income needs, high fees and other obstacles have limited this option. (Sinai and Souleles 2007) This suggests these studies may be underestimating the degree of retirement income inadequacy.

Nor do households seem to be having an easy time drawing down savings that have accumulated in DC plans. The Boston College and Federal Reserve studies assume that households “annuitize” - convert into lifetime streams of income - their financial wealth, but in practice this tends not to happen. Although employers that offer DC plans could provide annuity payout options, they rarely do. (Perun 2007)

Rather, households appear to be trying, not always successfully, to draw down their retirement savings on their own. A recent study by the Employee Benefit Research Institute found that large numbers households seem to be drawing down these funds too quickly, raising the risk that they will deplete their savings before they die. (Copeland 2007) And at the other extreme, there is evidence that retirees may be holding on to DC plan assets too tightly. (Copeland 2007; Love et al 2007) While drawing down assets “too slowly” may be less of a public policy concern than spending them too fast, it does mean that some retirees’ standard of living is lower than it could (or should) be. This phenomenon could be due to a lack of knowledge about how to draw down assets in an optimal way, or to psychological factors, whereby retirees, fearful of depleting their savings, deprive themselves of things they want or need. Either way, retirees’ difficulties in making the leap from saving for retirement to spending in retirement have real consequences for their living standards.

Restoring Retirement Readiness

The evidence is clear - DB pensions provide, as a practical matter, the best path to retirement readiness for ordinary Americans. The shift away from DB pensions in recent years has coincided with a decline in retirement wealth for the typical household, reducing retirement readiness and increasing the risk of hardship in old age. This means

fewer working families will have a good chance of maintaining a middle-class living standard in retirement.

Thus, rebuilding the promise of retirement security will mean protecting, strengthening, and expanding DB pension coverage for American workers. In the short- to medium-term, policy makers should focus on ways to shore up existing DB pension plans. This will require a fine balance between making sure that employers have the right incentives to maintain their DB pension plans, but also contribute enough to the plans so that employees do not have to worry about the security of their promised benefits.

Two initial steps seem necessary to achieve this balance. First, the rules governing the funding of private sector DB pension plans should be re-examined. In addition, models of DB pension plan design that insulate employer contributions from shocks, that reduce the possibility of large swings in annual contributions, and that secure employees’ retirement benefits deserve a second look. Such designs include, but are not limited to multiemployer DB pension plans in the private sector and multiple employer public sector pension plans.

In the longer term, identifying channels through which new plans can be established or existing plans can be expanded will be necessary. Some of the initial lessons from recent experience in the U.S. and abroad point the direction towards some promising policies. Common to all of these approaches are the pooling of funds across employers, industries and occupations and the role of the government in serving as an incubator for new, well-functioning, secure pensions.

Future research and policy analysis from the National Institute on Retirement Security will explore these themes and others in greater depth. A key goal of our work is to inform the public policy debate around issues of retirement security in the U.S. In light of some of the trends described herein, there is much at stake. The ability of millions of ordinary Americans to sustain their middle-class standards of living into their retirement years is one we as a nation cannot afford to ignore.

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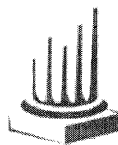
Beth Almeida is the Executive Director of the National Institute on Retirement Security. Before joining NIRS, she served as assistant director for strategic resources and as senior economist with the International Association of Machinists and Aerospace Workers (IAM) where she was instrumental in transitioning some 40,000 airline employees out of terminating or freezing pensions into the IAM's multi-employer defined benefit pension plan. Earlier in her career, Ms. Almeida led research initiatives at academic centers in Germany, France, and her home state of Massachusetts. She has authored numerous economic and pension publications and is a frequent speaker at academic and industry conferences, both in the US and abroad. Beth earned a bachelor's degree in international business from Lehigh University and a master's degree in economics from the University of Massachusetts Amherst.

About NIRS

National Institute on Retirement Security is a non-profit research institute established to contribute to informed policy making by fostering a deep understanding of the value of retirement security to employees, employers, and the economy as a whole. NIRS works to fulfill this mission through research, education, and outreach programs that are national in scope.

ISSUE BRIEF

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NATIONAL INSTITUTE ON
Retirement Security

Reliable Research. Sensible Solutions.

Patience is a Virtue

Asset Allocation Patterns in DB and DC Plans

By Ilana Boivie and Beth Almeida

Introduction

Public and private retirement funds represent a considerable source of capital in U.S. financial markets. In 2007, retirement plans held close to \$9 trillion in assets. Such retirement plans encompass traditional pension plans, also called defined benefit (DB) plans, where assets are invested and managed on a group basis, and defined contribution (DC) plans, where individuals typically direct investments on their own. This Issue Brief examines how these plans invest their assets and how these investments have changed over time.

The past few decades have witnessed significant changes in retirement plan coverage, especially in the private sector. Traditional pension coverage in the private sector has decreased drastically in recent decades. Today, while 80% of state and local government workers are covered by traditional DB pension plans, only 14% of workers in the private sector are covered by DB plans. DC plans, on the other hand, are the primary retirement plan for 10% of state and local employees, but a full 64% of private employees. (Munnell, Haverstick & Soto 2007)

We examine whether the move from DB to DC plans has had an impact on the way retirement assets are invested. Individual investors, for instance, may have a shorter term investment horizon than DB plans. This raises questions about the risk exposure and investment performance of DC plans relative to DB plans. The shift from DB plans to DC plans may have reduced the supply of patient capital over time, meaning that businesses may have a harder time than in the past getting the financing for long-term productive investment projects.

Key Findings

Using data from the Federal Reserve's Flow of Funds database and other sources, this issue brief finds that:

- Investments of public sector pension plans and private sector DB plans closely resemble each other. In 2007, both types of plans allocated 63% of their assets to corporate stocks, compared to a direct stock allocation of only 37% for DC plans.
- Over the past decades, public sector pension plans have increased their equity allocation to catch up with their private sector counterparts. In 1985, public sector DB plans allocated only 29.9% of their assets to corporate stocks, while private sector DB plans already held 42.3% of their assets in corporate stocks. Private sector DC plans lowered their direct stock holding over the past two decades.
- Legal and regulatory obstacles to portfolio diversification have been reduced over time. This has allowed public sector plans to better balance their asset allocations with their long-term investment goals.
- Defined benefit plans are more long-term investors than DC plans. DC plans shift their allocation to and from corporate stocks more frequently than their DB plan counterparts do. This raises serious questions about the overall risk embedded in individual accounts, the consequences for retirement security and the availability of long-term financing for productive business investments.

Defined Benefit Plans Hold More of Their Assets in Corporate Stocks

The primary focus of any discussion on portfolio allocation is the degree to which assets are spread among a range of assets, including higher return/higher risk assets, such as corporate stocks. This is because incurring some risk will allow investors to take advantage of higher rates of return, especially over long periods of time. Also, if the risk in one asset is unrelated to the risk in another, the allocation to one asset offers some insurance against a decline in the value of other asset classes. That is, diversification into a number of different assets can help to substantially improve retirement income security by enhancing investment returns. Corporate stock returns fluctuate because they help to finance long-term, uncertain business investments. These investments are critical for productivity, economic, wage and profit growth over time. Without financial investors, such as retirement plans willing to take some risk in their portfolios, businesses could not finance their longer-term projects and economic growth may be slower than would be otherwise the case.

The data show that DB plans have most of their assets allocated to widely dispersed holdings of corporate stocks. Table 1, calculated from Flow of Funds data from the Federal Reserve Board of Governors (2007), shows the dollar value of assets by asset class for public sector plans, private sector DB plans and private sector DC plans. It also shows the percent of total assets allocated to each class for each type of plan. Table 1 shows that for each type of plan, assets

are spread across a range of different types of investments. Public plans and private sector DB plans look quite similar in terms of the percentage of assets allocated to each category. This is probably not surprising considering that in 2006, 95% of funds in public plans were DB plan assets. (BOG 2007 and Census 2007)

Private sector DC plans are more reliant on mutual funds and “other investments” (a category that includes insurance contracts and municipal securities) than public plans or private DB plans. DC plans also hold more liquid assets than other types of plans.

Pension Plans’ Diversification Reflects Tenets of Modern Portfolio Theory

At a high-level, then, retirement plans appear to be broadly diversified. Such a pattern of diversification reflects the tenets of modern portfolio theory, which was first introduced by Harry Markowitz in his 1952 paper “Portfolio Selection.” This theory states that rather than focusing on the risk and return of any individual stock or asset, an investor should instead concentrate on ensuring diversification of assets across the entire portfolio. Markowitz found that what he called the expected return-variance of return rule “implies diversification [and] leads to efficient portfolios almost all of which are diversified.” (Markowitz 1952) In other words, the more diversification in one’s overall portfolio, the more that overall risk is minimized, and this minimization of risk ultimately provides for greater efficiency of investment.

Table 1

Assets Held in Public and Private Sector Pension Plans, 2007
(in billions of dollars)

	Cash and Liquid Assets	Treasury and Agency Debt	Corporate and Foreign Bonds	Stocks	Mutual funds	Other Investments	Total
Public Plans	\$64	\$534	\$249	\$1,981	\$296	\$16	\$3,139
Private DB	\$55	\$254	\$212	\$1,471	\$226	\$116	\$2,334
Private DC	\$160	\$161	\$101	\$1,296	\$1,385	\$378	\$3,480
(as a percent of total)							
Public Plans	2%	17%	8%	63%	9%	1%	100%
Private DB	2%	11%	9%	63%	10%	5%	100%
Private DC	5%	5%	3%	37%	40%	11%	100%

Source: *Flow of Funds*, (BOG 2007). Stocks include both foreign and domestic equities.

The seminal role of modern portfolio theory was recognized in 1990 when Markowitz, along with Merton Miller and William Sharpe, received the Nobel Prize in Economics for his work on the subject. Since 1952, other researchers have built on the foundations laid by modern portfolio theory and the field has developed sophisticated techniques to assist investors in designing “optimal portfolios,” which balance the tradeoffs between risk and return embedded in any range of investment options. Researchers continue to verify the importance of portfolio diversification as a tool to manage risk. (See Abdelazim & Wahba 2006; Teulings & de Vries 2003; Elton & Gruber 1997)

In DB plans, where investment decisions are made by professionals, we would expect asset allocations to reflect this tenet of portfolio diversification, especially because different asset classes have different roles to play within a portfolio in order to best diversify overall risk. A discussion of the various asset categories and the role they play in a diversified portfolio appears in the Appendix to this brief.

DC plans, where asset allocation decisions are made by individuals, appear diversified at a high level, but as we will see, these data mask how assets are allocated at the individual account level.

Stock Allocations in Public Plans Have Caught Up to Private Plans

The manner in which retirement plans allocate their assets has changed over time. Table 2, calculated from the Flow of Funds, presents asset allocation data for public and private sector pension plans starting in 1985, at five-year intervals, and ending with the most recent year, 2007. Historically, as shown in Table 2, both public- and private-sector retirement plans have invested in a broad range of assets.

In 1985, the largest differences in asset allocation were between private- (both DB and DC) and public-sector plans, largely because of restrictions which hampered diversification in public plans. That year, public-sector plans tended to invest much more heavily in bonds and less heavily in stocks and other investments, as compared with private plans.

However, each type of plan allocated the largest proportion of assets to stocks. Private DB plans designated 42.3% of funds to stocks, similar to private DC plans’ 41.7% allocation. Public sector plans allocated just 29.9% of funds to equities. All types of plans invested only a small percentage of assets in mutual funds, at 0.7% of funds for private DB plans, 1.2% for private DC plans, and 1.7% for public plans.

Table 2

Asset Allocation of Public and Private Sector Pension Plans, 1985-2007
(% of Assets)

	<u>Cash and Liquid Assets</u>			<u>Treasury and Agency Debt</u>			<u>Corporate and Foreign Bonds</u>			<u>Stocks</u>			<u>Mutual Funds</u>			<u>Other Investments</u>		
	Private DB	Private DC	Public	Private DB	Private DC	Public	Private DB	Private DC	Public	Private DB	Private DC	Public	Private DB	Private DC	Public	Private DB	Private DC	Public
1985	7%	12%	6%	21%	13%	32%	10%	5%	27%	42%	42%	30%	1%	1%	2%	20%	27%	4%
1990	8%	12%	4%	25%	9%	33%	12%	7%	20%	38%	36%	39%	1%	5%	1%	17%	31%	3%
1995	6%	6%	4%	19%	6%	23%	12%	4%	14%	47%	40%	53%	5%	20%	5%	11%	24%	2%
2000	5%	5%	3%	12%	5%	18%	10%	3%	14%	54%	36%	57%	12%	36%	8%	8%	15%	1%
2005	2%	5%	2%	12%	4%	17%	9%	3%	8%	61%	38%	63%	11%	38%	9%	5%	12%	1%
2007	2%	5%	2%	11%	5%	17%	9%	3%	8%	63%	37%	63%	10%	40%	9%	5%	11%	1%

Source: Flow of Funds, (BOG 2007)

Notes: Because of rounding, figures may not sum to 100%. Authors’ calculations based on Flow of Funds (BOG 2007)

The different types of plans diverged the most during this time on allocation to “other investments” (which included investments like real estate as well as insurance contracts and municipal securities). Private DB plans invested 19.6% and private DC plans invested 27.3% in these assets, while the public sector invested only 3.9% of funds in these “other investments.”

Plans also differed on allocations to corporate and foreign bonds with public plans investing more heavily, with 26.7% of assets in bonds, compared to just 9.8% for private DB plans and 4.5% for private DC plans. The same pattern held for treasuries and agency debt (32.3% for public funds, 20.5% for private DB and 12.7% for private DC).

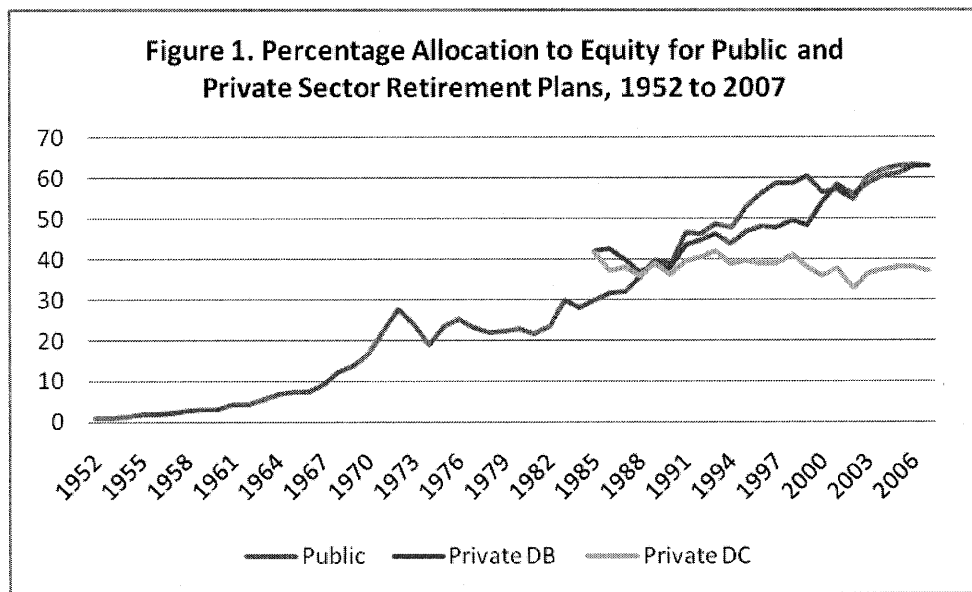
By 2007, the picture had changed. The largest discrepancy was no longer between public and private funds, but rather between DB and DC plans. Public sector plans’ asset allocation closely mirrored that of private sector DB plans, with both types invested most heavily in stocks. The proportion of funds allocated to stocks increased substantially, to 63.0% for private DB and 62.9% for public plans. Private DC plans, meanwhile, reduced their allocation to stocks, to 37.2% of assets, but dramatically boosted their allocations to mutual funds. Also, the large discrepancy between the public plans and private DB plans’ allocations to corporate and foreign bonds that existed in the 1980s virtually vanished: private

DB plans allocated 9.1% and public plans invested 8.2% of funds to this asset class in 2007. Again, private DC plans differed, allocating just 2.9% to corporate and foreign bonds in 2007.

Since the 1980s, then, we have seen a steady convergence in asset allocation patterns of public plans and private sector DB plans, with the result that in 2007 public and private DB plans look very similar. Private sector DC plans have notably different asset allocations, in particular with their much heavier reliance on mutual funds. It should be noted that this period, 1985 to 2007, witnessed a virtual explosion in private sector DC plan participation. Assets in such plans grew from \$431.7 billion to almost \$3.5 trillion.

Legal and Regulatory Changes Have Enhanced Plans’ Diversification

Public pension plans have been steadily increasing the proportion of stocks in their portfolios over time. As far back as 1953, only 1.5% of public plan assets were allocated to stocks, but by 2007 stock allocation had increased to 60.3%—a level on par with private-sector DB plans. (BOG 2007) Figure 1 shows the percentage of portfolio funds allocated to equity since 1952 for public-sector plans, and since 1985 (the first year data is available) for private DB and DC plans.



Source: Flow of Funds (BOG 2007) and authors’ calculations.

Public pensions' transition to portfolios more heavily weighted toward equities has been gradual and occurred over a period that saw these plans move from operating more as pay-as-you-go systems (in which, similar to Social Security, current contributions to the system pay for current retirees' benefits) to pre-funded entities (in which each employee's pension is funded throughout his/her career). In 1952, the public plan system held just \$6.6 billion in assets; by 2007, having fully moved to a pre-funding system, public plans held \$3.1 trillion in assets. (BOG 2007)

Along with the move to pre-funding came a series of legislative adjustments to lower restrictions on public plans' investment options. Up to that time, many public plans' investment activities were strictly constrained by "legal lists" and other legislative dictates. (Mitchell et al. 2001) Although these funds were restricted by state legislation from owning certain securities at one time, eventually, "under pressure by local lobbying from public funds and faced with data showing the relatively poor returns earned by such restricted funds, [many] states amended their rules." (Wallace 1983) With these two changes, public pension plans began shifting to a longer-term view of investment allocation, and thus moved more into equity. (Logue and Rader 1998) That is, public sector DB plans were finally able to "catch up" to the private sector in diversified, efficient asset allocation, resulting in "high returns earned in financial markets, especially domestic equities." (Mitchell et al. 2001)

Turning to private sector DC plans, the period 1985 to 2007 witnessed substantial change. In 1985, 401(k) plans had not yet been widely adopted. At that time, assets in private sector DC plans stood at \$432 billion, with many DC plans set up as Employee Stock Ownership Plans (ESOPs). ESOP adoption peaked in 1993. (National Center for Employee Ownership 2008) Employers preferred ESOPs because they gave them the ability to leverage plan assets, which ultimately decreases the tax burden of the company. (Munnell & Sunden 2004)

The mutual fund industry grew up along-side the growth of DC plans, as mutual funds seemed to represent the "logical investment for 401(k) plans." (Munnell & Sunden 2004) That is, with most employers electing not to bear the responsibility of managing DC plan assets,

mutual funds stepped in as a way for employees to achieve some diversification in their 401(k) accounts. Today, DC plans are ubiquitous in the private sector, with 58 percent of households depending solely on 401(k) or similar plans in 2001, (Munnell & Sunden 2004) and assets totaling \$3.5 trillion in 2007, (BOG 2007) with investment of these assets almost entirely self-managed.

Changes to Asset Allocations in Public Plans Have Been Gradual and Smooth

Given the differences in investment patterns between plans and the changes in these patterns over time, it may be useful to examine the extent to which changes in asset allocations have been gradual and smooth, versus volatile and unpredictable. Increased volatility may be an indication that investors in one particular type of retirement plan are less patient with their financial investments.

In particular, investors in DC plans may be less patient with their financial investments than DB plans because individuals have a shorter time horizon during which to invest. Importantly, if the shift to DC plans has gone along with more volatile financial market investments in certain assets, it may indicate that businesses may have found it harder to find the necessary long-term financing for their projects through traditional financing vehicles, such as stock issues.

To assess the volatility of the portfolio allocation of a particular type of retirement plan, we calculate the standard deviation (a typical measure of volatility) of the change in the share of assets plans allocate to equity. Table 3 shows these standard deviations, measured on a quarterly basis, since 1952, for state and local plans as well as for private plans.

However, the better measure of volatility in one's portfolio allocation may be the relative standard deviation, considering that both types of plans have seen allocation to equities change over time. The relative standard deviation is the standard deviation relative to the average. In this case, the standard deviation of the quarterly growth rate of the equity allocation for a particular type of plan over a specified period of time is divided by the average growth rate of the equity allocation for that type of plan during the particular time period.

Table 3
Volatility and Relative Volatility of Asset Allocation
in Public and Private Sector Retirement Plans,
1952-First Quarter 2008

	Public Sector Plans	Private Sector Plans
Total standard deviation 1952-2008	1.3	1.8
Relative standard deviation 1952-2008	4.8	12.5
Last 30 year standard deviation	1.5	1.6
Relative 30-year standard deviation	4.6	32.2
Last 20 year standard deviation	1.5	1.3
Relative 20-year standard deviation	2.2	12.1
Last 15 year standard deviation	1.5	1.1
Relative 15-year standard deviation	5.2	13.6

Source: Authors' calculations based on data from Flow of Funds (BOG 2007)

Table 3 shows that changes to equity allocations in state and local plans exhibit much lower volatility than private plans. Overall, since 1952, changes to private plans' equity allocations have been nearly three times more volatile, with a relative standard deviation of 12.5, as compared with public plans' 4.8 relative standard deviation.

Even within the last fifteen years—during which public plans have been substantially increasing allocations to equity—the standard deviation of changes to public plan equity allocations is only slightly higher than that of private plans (1.5 versus 1.1), and the relative standard deviation is still significantly lower (5.2 versus 13.6).

These results strongly suggest that changes to equity allocations for public plans have been more stable than those of private plans.

Asset Allocation Changes in DC Plans Have Been More Volatile

Because DB and DC investments have varied so much in recent years, it may also be valuable to analyze the volatility of changes in equity allocations for such plans in the private sector.

Due to data limitations, we can only examine this back to 1985, and only on an annual basis. Results appear in Table 4, which show that changes in equity allocations in DC plans have been much more volatile than those of public plans or private sector DB plans.

Overall, since 1985 all three types of plans showed similar standard deviations, with 0.07 for private DC, 0.06 for private DB, and 0.06 for public plans. The relative standard deviation, however, was just 3.0 for private DB and 1.8 for public sector plans, but a sizeable 473.0 for private DC plans.

Within the last 15 years, the volatility in equity allocations for private DC plans remained similar to the 22-year total, at 0.06, while volatility for other plans declined slightly, to 0.05 for private DB and 0.05 for public plans. The relative standard deviation for the last 15 years shows that even in this shorter timeframe, changes in equity allocations in private DC plans have been much less stable than for other plans, with a measurement of 10.8 for DC plans, compared to 2.0 for private sector DB plans and 2.3 for public sector plans.

Table 4

**Volatility and Relative Volatility of Private DB, Private DC,
and Public Sector Pension Plans, 1985-2007**

	Public Sector Plans	Private Sector DB Plans	Private Sector DC Plans
Total standard deviation 1985-2007	0.06	0.06	0.07
Relative standard deviation 1985-2007	1.8	3.0	473.0
Last 20 year standard deviation	0.06	0.06	0.06
Relative 20-year standard deviation	1.9	2.4	58.5
Last 15-year standard deviation	0.05	0.05	0.06
Relative 15-year standard deviation	2.3	2.0	10.8

Source: Authors' calculations based on data from Flow of Funds (BOG 2007)

Other recent findings corroborate the conclusion that allocations to equity in DB plans may be more stable and efficient than allocations to equity in DC plans. For example, Holden and VanDerhei (2001) found that more than half of all DC plan participants had either no funds invested in stocks, which exposes them to very low investment returns, or had almost all their assets allocated to stocks, making for a much more volatile portfolio. Another diversification shortcoming in DC plans is the issue of company stock. Many employees have large holdings of their own employer's stock in their DC plans. Among large employers, company stock made up 37.6% of assets in DC plans. (Profit Sharing/401k Council of America 2002) The risk inherent in this practice was summed up in the case of Enron, where employees had some 60% of their DC plan assets allocated to their employer's stock, which became worthless when the company crashed. (Munnell & Sunden 2004)

That DC plans exhibit higher volatility in asset allocation than DB plans suggests different investment behavior between individuals and institutional investors. This is perhaps not surprising, considering that public sector plans and private sector DB plans are professionally managed with "considerable financial education, experience, discipline and access to sophisticated investment tools" (Watson Wyatt 2008), while the individualized nature of DC plans means that these rely on self-management.

Such factors may help to explain why DC plans tend to achieve poor investment returns, as compared with DB plans. A 2007 report from the global benchmarking firm, CEM, Inc., concluded that between 1998 and 2005 DB plans showed annual returns 1.8 percentage points higher than DC plans, largely due to differences in asset mix. (Flynn & Lum 2007) And Watson Wyatt (2008) found that between 1995 and 2006 DB plans outperformed DC plans by 1.09 percentage points annually, on average.

Policy Challenges Presented by Asset Allocation Patterns in DC Plans

In light of the explosion in DC plan participation in the private sector, these findings present a challenge. Inefficient asset allocation and the resulting lower investment returns may leave individuals with insufficient resources to meet their needs in retirement.

Research in the field of behavioral finance reinforces these concerns, with findings that most individuals are relatively poor at making investment decisions (van Rooij 2007), and possess "little knowledge of the investment strategies or financial details of their investments." (Capon et al. 1996) Many employees make the mistake of chasing short-term returns, which often leads to the practice of buying high and selling low, and which reduces overall returns, while increasing standard deviation of return. (Watson Wyatt 2008; Keim 2003) Moreover, many individuals understand

that they can be poor investors: a recent survey of 1,000 Dutch citizens found that the “average respondent considers himself financially unsophisticated and is reluctant to take control of retirement savings investment, even when offered the possibility to increase expertise.” (Orth 2006)

Also, because DC plans are individually managed, they do not have access to certain asset classes, especially alternative investments such as private equities, hedge funds and venture capital, which require investments in the millions of dollars. Because such alternatives can offer high rates of return that may not be correlated with the returns of other assets, the inability of individuals with DC plans to invest in these assets presents a significant disadvantage to their investment strategies and overall portfolio returns.

Overall, economists and financial analysts generally agree that taking on appropriate risk in one’s portfolio is advisable, especially in the long term. (Romaniuk 2006; Campbell & Viceira 2002; Srinivas et al. 2000) Maintaining a reasonable mix of low, medium, and higher risk investments in one’s portfolio is both an important aspect of diversification, as well as a prudent and efficient way to maximize returns in the long term. (Romaniuk 2006; Siegmann 2003)

Congress essentially endorsed this principle—that individuals should take on equity risk as part of a diversified portfolio—in its passage of the 2006 Pension Protection Act (PPA). The PPA not only allows employers to automatically enroll employees in a DC retirement plan (PPA Section 902), but also permits employers, under this automatic enrollment, to direct assets to be invested in a “qualified default investment alternative” (QDIA). (PPA Section 624)

Congress explicitly recognized that most individuals have a difficult time effectively managing their own portfolios in its designation of four types of QDIAs allowed under the regulation, which include life-cycle or targeted-retirement-date funds, in which the asset allocation changes based on an employee’s age, a professionally managed account, and a balanced fund. (U.S. Department of Labor 2008) These PPA regulations represent a Congressional attempt to encourage enrollment in a retirement portfolio consisting of some risk—but especially in one that is managed, or at least designed, by professional managers.

Conclusion

The evidence indicates that professional asset management provides important benefits for retirement plan participants and the employers who sponsor retirement plans. Economic growth is boosted as businesses tap patient capital for long-term projects. Professionally-directed asset allocations are more likely to reflect an optimal strategy of diversification, generating investment returns that are higher and more stable, thus lowering the costs of delivering retirement benefits and improving benefit adequacy.

Unlike individuals, who must adopt more conservative investment strategies as they age, DB plans, whose participants can include young, middle-aged, and retired individuals, are not bound by such life-cycle based constraints and can remain invested in equities because of their perpetual nature. Thus, the greater stability in asset allocations, or patient capital, among public plans and private sector DB plans may also provide benefits for financial markets as a whole, since professional investors who follow a long-term strategy are less likely to cause market disruptions by chasing short-term returns.

The dramatic shift away from professionally-managed group DB plans in the private sector in favor of individually-directed DC plans raises important policy concerns. Although Congress has taken steps to attempt to foster more efficient asset allocations in individual DC plan accounts, it is too soon to know what effect these attempts may have. Considering the research findings presented herein, any steps by policymakers that can encourage more optimal asset allocations in DC plans are to be welcomed. However, so long as investment decisions in DC plans are directed by individuals, the risk of less-than-optimal asset allocations will still exist. Another concern is that because there is no easy way for individuals to capture the uncorrelated returns offered by alternative investments, it seems that individual DC plan participants will remain at a disadvantage as compared with professionally managed DB plans.

Our findings suggest that the seismic shift from DB to DC plan coverage, at least in the private sector, has been accompanied by equally important shifts in asset allocations. While the ultimate effects are not yet known, these shifts have been significant enough to warrant further study on their potential consequences.

Appendix

The Role of Stocks and Bonds in a Diversified Portfolio

Perhaps the most important way to diversify one's portfolio is between stocks (mainly corporate equities) and bonds (including treasury debts as well as corporate bonds). Bonds, whose returns tend to be more stable than those of equities, can help to reduce the volatility of investment returns, when they are used as part of a diversified portfolio. Stocks are an important asset class for long-term investors because they offer much higher rates of return over longer time horizons, as compared with bonds.¹ (Siegel & Thaler 1997) Mutual funds, which account for a large share of DC plan assets, may be invested in stocks, bonds, liquid assets, or a combination thereof. Mutual funds are a favored way for individuals to invest, because they allow small investors (or even large ones) a simple way to achieve a broadly diversified portfolio. For example, an investor can purchase shares of a S&P 500 mutual fund, which will mimic the performance of all 500 stocks in the S&P index. In 2007, for instance, 74.2% of mutual fund assets were allocated to common and preferred stocks, 8.4% to long-term U.S. government bonds, 8.8% to corporate bonds, 4.1% to municipal bonds, 4.2% to liquid assets, and 0.2% to other investments. (Investment Company Institute 2008) In this way, even a small investor can get a broad, diversified exposure to hundreds of individual stocks. Allocation of assets to both stocks and bonds, either directly or through mutual funds, then, is the most common way to obtain at least a moderately diversified portfolio.

The Role of Other Investments in a Diversified Portfolio

The Flow of Funds "other investments" category comprises assets such as unallocated insurance contracts (including guaranteed investment contracts (GICs) and variable annuities) as well as so-called "alternative investments" such as private

equity, hedge funds, real estate, and commodities. Unallocated insurance contracts are contracts with an insurance company under which payments are accumulated in a fund to be used to meet benefit payments, either directly or through the purchase of annuities. Variable annuities are insurance contracts in which the insurer makes periodic payments, either at present or in the future. GICs are contracts under which, once a lump-sum payment is made, the insurer ensures a relatively high interest rate for a set amount of time. Unallocated insurance contracts "were introduced by insurers to attract large pension funds" (Investments & Income 2008), because they are a good hedge against overall market risk in that, similar to bonds, they offer a fixed rate of return; however, the rate of return is usually higher than that of bonds.

The Role of "Alternative Investments" in a Diversified Portfolio

"Alternative investments" include assets such as real estate, commodities, financial derivatives, hedge funds, private equity, and/or venture capital. Real estate and commodities are sometimes referred to as "real" assets, in that these investments are actual physical goods, unlike most financial assets. Commodities—which include agricultural goods and other resources such as crude oil, iron ore, and gold—and real estate both serve as a hedge against inflationary pressures. (Steil 2008) In the face of inflation, when the value of most financial assets decreases, investment in real estate or commodities can protect the real value of one's portfolio. Real estate specifically is commonly believed to show a "strong record of high-return, low-volatility performance," due to its heterogeneity, which is a means, once again, of diversification. (Logue & Rader 1998)

Other alternatives that are used to diversify portfolios, such as hedge funds, private equities and venture capital, have traditionally held a reputation for being higher risk investments with the potential for high returns. However, such investments are often incorporated into a portfolio, not because of higher expected rates of return, but because they can offer uncorrelated returns that are somewhat insulated from stock market shocks. That is, should the market as a whole see a substantial downturn, these alternatives can be somewhat more shielded from showing a large loss than other equities might be, due to their relative independence. (Seco

¹ The greater rate of return that equities have delivered, what economists call the "equity premium," can only partly be attributed to stocks greater riskiness. Economists have determined the size of the equity premium is too large to be explained by standard economic models, and have labeled this phenomenon the "equity premium puzzle."

2005; Phillips & Surz 2003; Indjic & Partners 2002)

This ability—to show just single digit losses in a market decline, for example, when other equities may show double digit losses—can significantly impact a retirement plan’s compounded rate of return over time. Thus, in recent years, some DB plans have allocated a small share of assets to “alternative assets.” In 2007, for example, a survey conducted of the 52 largest public pension funds reported that the average allocation to real estate was 5.5% of assets, private equity 5.7% of assets, and hedge funds 1.1% of assets. (NASRA 2007)

In order to successfully invest in these “alternative” assets, investors must have a long time horizon and must have a high degree of sophistication to understand these often-complex investments. These factors can make alternatives a sound investment choice for DB plan investors, which have the benefit of professional investment advisors and staffs, very long-term time horizons, and the need and ability to diversify to reduce risk.

Individual investors in DC plans typically do not have the access or the expertise to invest in these types of assets, which may put them at a disadvantage. Data from Watson Wyatt (2008) show that during 2000-2002 market downturn, DB plans outperformed DC plans, in part, because of their exposure to a broader range of assets, including alternatives. The decision to invest a small proportion of one’s portfolio in such alternative investments once again follows modern portfolio theory’s central principle of diversification. In other words, when DB investors choose to allocate some assets to alternatives, they are employing a reasonable, long-term investment strategy. (James & Karceski 2002)

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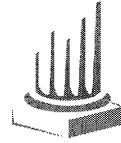
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ISSUE BRIEF

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NATIONAL INSTITUTE ON
Retirement Security

Reliable Research. Sensible Solutions.

Look Before You Leap

The Unintended Consequences of Pension Freezes

By Ilana Boivie and Beth Almeida

Introduction

Americans are increasingly worried about their retirement security in the face of falling home values, turmoil in the financial markets, and general economic instability. This insecurity can, at least in part, be attributed to the fact that fewer workers and retirees are able to count on a secure, predictable monthly pension, as more employers in the private sector have “frozen” participation in their pension plans. The trend away from traditional defined benefit pension plans in the private sector in favor of individual retirement savings accounts (such as those found in defined contribution plans) has left Americans especially vulnerable to the volatility in financial markets.

With the economy becoming weaker, many state and local governments will be facing fiscal challenges in the months and years ahead. These challenges will undoubtedly prompt governments to carefully examine all aspects of their budgets, including pension costs for state and local workforces. Policymakers may be wondering, “Are secure retirement benefits for our employees still affordable?” or “Should we consider shifting to a defined contribution approach?”

This brief explores important factors public employers should keep in mind when making decisions about their retirement programs. We conclude that caution should be the watchword for governments that might be tempted to follow

the trend in the private sector to abandon defined benefit (DB) pensions in favor of defined contribution (DC) plans.

Key Findings

We find that freezing DB plans can have several serious, unintended consequences.

- Freezing a DB pension and moving to a DC plan can increase costs to the employer/taxpayer at exactly the wrong time. This is because ...
 - Maintaining two plans is more costly than operating just one;
 - Forgoing and undermining the economic efficiencies of DB pensions drives up retirement plan costs; and
 - Accounting rules can require pension costs to accelerate in the wake of a freeze.
- Freezing a DB pension and moving to a DC plan can worsen retirement insecurity, potentially damaging recruitment and retention efforts.

Because of this, most states that have studied whether to freeze a DB and switch to a DC plan have found continuation of the DB plan to be in the best interests of employers/taxpayers and employees.

The Anatomy of a Pension Freeze

An employer “freezes” a pension plan when it limits the ability of employees to earn benefits in the plan. An employer may have the option to “freeze” a pension by ending benefit accruals in the plan for all employees (sometimes described as a “hard freeze”), or to close the plan to newly-hired employees only (a “soft freeze”). Generally speaking, employers in the private sector have some latitude in deciding whether and how to freeze a plan. In the public sector, because of differences in the legal protections of benefits, employers are often limited to restricting freezes to new hires (soft freezes). Many employers have established new DC plans (or enhanced existing DC plans) in the wake of a pension freeze.

According to the Government Accountability Office (GAO) nearly half of private sector DB pension plans are currently closed to new entrants.¹ Although employers often establish a new DC plan after freezing a DB pension plan, researchers have found that the replacement DC plans typically offer much less generous benefits than the DB plans being frozen.² Thus, given the high number of firms choosing to freeze their plan, it appears that fewer and fewer workers will receive secure retirement benefits in the future.³ When DB pension plans are frozen, workers can experience grave consequences. Although the precise impact of a DB to DC switch hinges on specific plan provisions and benefit formulas, in general, mid-career and older workers will see the largest reductions in retirement income when a DB pension is frozen and replaced with a DC plan.⁴

In contrast to the unfortunate chill that has settled in over private sector DB pension plans, public sector plans are still faring well. Some 80 percent of public sector workers are still covered by a traditional pension, and, according to a recent GAO report, the majority of public sector pension plans have been fiscally sound, with a funded ratio of 80 percent or higher.⁵ The consulting firm Wilshire Associates found that funding levels for 125 state pension plans increased to 95 percent in 2007 from 88 percent

in 2006.⁶

Despite the health of pension plans in recent years, state or local governments may be looking down the road to a tighter budget environment, especially in these tough economic times. When this occurs, proposals can surface to freeze DB pension plans and switch to DC plans as a way to save money. However, a careful examination of just what a plan freeze entails shows that freezing the plan will typically cause costs to *increase* significantly in the short run—not exactly the desired result for a state or municipality that is already in economic turmoil.

Freezing a Pension Plan Can Increase Costs

Freezing a DB and moving to a DC plan can actually increase costs to public sector employers (and therefore, taxpayers) for several reasons.

First, there is the simple fact that maintaining two plans is more costly than operating just one. State and local governments typically do not have the option of transferring all employees out of a DB plan and into a new DC plan. Because of legal protections, it is often the case that only newly-hired employees may be “frozen out” of a DB plan in the public sector.⁷ This means the employer/taxpayer will have to bear administrative costs for two plans, at least until the DB plan is finally phased out completely, a process that could take many decades as employees in the system complete their careers, retire, and ultimately die.

Second, employers that switch to DC plans will forgo the built-in economic efficiencies inherent in DB plans, and freezing a DB plan will actually undermine the economics of a frozen plan over time. The economic efficiencies embedded in DB plans are substantial and stem from the pooled, professionally managed nature of these plans. DB plans save money by pooling risks and achieving greater investment returns, as compared with DC plans. According to one estimate, a DB plan can provide the same retirement income at about half the cost of a DC plan.⁸ Thus, when a DB plan is frozen and replaced with a DC plan, far greater contributions from both employers/taxpayers

and employees will be required to maintain the same level of benefit in the DC plan.

Of course, employers/taxpayers could save money by cutting retirement benefits, but by forfeiting the economic efficiencies embedded in DB plans, a switch to a DC will entail an even greater reduction in benefits than what would otherwise be required if benefits in the DB plan were modified. Moreover, benefit cuts (whether within a DB plan or as part of a DB-to-DC switch) would not be without repercussions (a point to which we return later).

Worse still, the frozen DB plan will, over time, see its economic efficiency erode. This is because freezing the plan prematurely accelerates the age profile of the plan, which can force changes to how the plan's assets are invested.

To illustrate this process, consider the advice that individuals in DC plans typically receive to gradually change their investment mix as they approach retirement age, forgoing higher return/higher risk assets like equities in favor of lower return/lower risk assets like bonds. While this is done for a good reason (to protect against market shocks later in life) it necessarily involves the sacrifice of some expected return. Unlike individuals, open (i.e. non-frozen) DB plans do not age. An open DB plan will have a mix of younger, middle-aged, and older participants, and for a mature plan, this mix will not change much over time. This means that an open DB plan can achieve better returns by maintaining a more diversified portfolio over time, as compared with individuals in DC plans who must shift to a more conservative asset allocation as they get closer to retirement age. Freezing the plan sacrifices valuable investment earnings employers/taxpayers could have profited from had newer hires still been covered by the plan.

The third reason why freezing a DB plan can drive up costs has to do with the accounting rules that govern public pension plans. These rules can cause an acceleration of required pension contributions—specifically, those to cover “unfunded liabilities”—in the wake of a freeze.

“Unfunded liabilities” exist in a DB plan when the value of assets in the pension trust is smaller than the value of plan's benefit obligations. A gap between the value of the assets in a plan and the plan's obligations can emerge for several reasons. For instance, unexpected events, such as a drop in the value of the fund's assets resulting from a shock to financial markets can lead to unfunded liabilities. But decisions on the part of the employer can also play a role—for instance an employer that fails to make required contributions to the plan, or that improves benefits in the plan without making commensurate contributions to pay for these, can also see unfunded liabilities develop in the plan.

Whether a DB plan is open or frozen, the obligation to pay for benefits earned in the past will remain. However, all the benefits in a pension plan do not become payable right away, because employees will only gradually become eligible to start drawing pension benefits. Accounting rules recognize this fact and allow these obligations to be paid for over time. But the Government Accounting Standards Board (GASB) does have rules prescribing exactly how this may occur.⁹

According to GASB, the payment period to fund these liabilities may be no more than 30 years and payments can be made either in level dollar amounts, or as a level percentage of the projected payroll of the active employees in the plan. In an open plan, payroll can be expected to continue to grow over time, as retiring employees are replaced by new hires, and average pay increases each year.

As a result, payment schedules in open plans can see the dollar amount of payments gradually increase, at the same rate as the growth in payroll. But once a plan is frozen to new entrants, the number of active members in the plan will steadily fall, as individuals retire, meaning an ever-smaller payroll base over which to spread payments. Because of this, accounting rules require that if a plan is frozen to new entrants, either the unfunded liability must be paid in level dollar amounts, or as a level percent of a decreasing payroll.

In practice, this means that payments to retire any unfunded liability in a frozen plan will tend to be more front-loaded, as compared with an open plan that spreads these costs over a growing payroll base. In other words, a pension freeze can have a similar effect of a household refinancing a 30-year mortgage into a 15-year mortgage. By making larger payments sooner, the debt is paid down faster. While a household may have good reasons to want to retire its mortgage debt sooner, it probably would not do so if it was experiencing a temporary economic rough patch. Similarly, accelerating pension payments is unlikely to be a helpful strategy for a state or local government looking for ways to manage through a difficult fiscal environment.

Accounting rule-driven spikes in pension contributions can be significant, as the State of Alaska found out when it froze participation in its DB plans in 2005. The freeze forced additional contributions to the Teachers Retirement System to the tune of 14% of payroll, and required contributions to the Public Employees Retirement System totaled an additional 9% of pay.¹⁰ These amounts were on top of the contributions that were otherwise required.

Ultimately, when the additional costs involved in a DB plan freeze—and a DC implementation—are known and accounted for, such a drastic move can be revealed as not only unnecessary, but as counterproductive.

A DB to DC Switch Can Hurt Retirement Security for Employees, Recruitment/Retention Efforts for Employers

As noted earlier, an employer can obviously reduce its pension costs by reducing the generosity of the benefits it offers, but doing so will have consequences. In theory, reducing employer costs by cutting benefits could be accomplished either by reducing benefits in a DB plan or as part of a switch to a DC plan. But the effect of any given reduction in employer cost will be more severe under a DB to DC switch than if benefits in the existing DB plan were reduced. Thus, a DB to DC plan switch will have a far

worse impact on workers' retirement security. As a result, such a switch will likely have repercussions that impact negatively on recruitment and retention efforts.

The recent experience in West Virginia is instructive. In 1991, the West Virginia Teacher's Retirement System (TRS), a DB plan, was frozen, and all newly hired teachers were put into a new plan, the Teachers Defined Contribution Retirement System (TDC).¹¹ The impetus for the freeze was large unfunded liabilities in the DB plan, which were the result of the failure of the state and many of the county school boards to make required contributions to the pension system for many years. In fact, for some years, from 1979 onward, the state and many of the county school boards failed to match even employee contributions to the retirement fund.¹² West Virginia continued adding new teachers to the TDC plan until 2004; after the state's Consolidated Public Retirement Board realized that many teachers had amassed very little in the way of assets for retirement. The average TDC account balance stood at just \$41,478, with a mere 105 of the 1,767 teachers over 60 years old having accumulated over \$100,000. (An account balance of \$100,000, if converted to an annuity, would provide a very modest monthly income of only about \$600 starting at age 65.) The most common reason cited by the teachers and school personnel for these "pitifully small" balances was their unfamiliarity with investing.¹³ The state, concerned that teachers with inadequate retirement income would require some form of governmental assistance—either in the form of an increased retirement benefit or welfare and Medicaid¹⁴—decided that effective June 30, 2005, all newly hired teachers would be enrolled in the traditional DB pension plan, TRS, which had historically proven to offer greater and more secure retirement income.¹⁵

The enhanced security offered by DB plans appears to be highly valued by public employees. Public employees consistently express strong preferences in favor of DB plans, according to national public opinion polls.¹⁶ And when public sector employees are given a choice between a

traditional DB pension and DC plan, overwhelmingly the workers choose the DB plan.

A mere 3.3% of employees, for example, in the Ohio Public Employee Retirement System (PERS) elected the DC plan over the DB pension when offered, while 63% of Washington State PERS members chose an all-DB plan over the default of a combined DB and DC plan.¹⁷

And, as lawmakers in West Virginia found out, the preference among state employees in favor of DB plans can actually work to the state's financial advantage as well. After the once-frozen DB plan (TRS) was reopened to new hires, the state allowed teachers who had been hired into the DC plan (TDC) to choose whether they wanted to remain in TDC, or switch over to TRS. The state's retirement board had estimated that 10 percent or fewer of younger teachers (under 40 years old) would opt back into the DB plan, given the widely held notion that DC plans are more popular among younger workers. But an overwhelming number of these younger teachers—over 75 percent of them—decided to make the switch back to the TRS. Because so many younger employees made the switch, this had the effect of reducing the cost of re-opening the DB plan. A far cry from its initial \$78 million cost estimate, West Virginia is now estimating that the switch to the DB will actually save the state \$22 million.¹⁸

These revealed preferences for DB plans suggest that the plans are very important in attracting and retaining public sector employees. Thus, experts warn that freezing these plans and switching to DC plans can hamper recruitment, and even result in high turnover rates, labor shortages, increased training costs, and lower levels of productivity.¹⁹

Studies Have Found that Freezing DB Plans and Switching to DC Costs More

Time after time, when states have studied whether to freeze a DB pension plan and move to a DC plan, they have found the cost of switching to be prohibitive. In Kansas, for example, a recent feasibility study found that moving to a DC plan would be significantly more expensive than

a DB system, so a new, modified DB plan was implemented for new hires instead.²⁰

A 2007 study conducted for the Employees' Retirement System of Rhode Island (ERSRI) found that, should the DB plan be frozen, the state would have to substantially *increase* payments to the ERSRI for several years in order to stay in compliance with governmental accounting rules. After some time, the study's authors found, payments to ERSRI may decline; however, they did not take into account any costs of administering or contributing to a replacement DC plan, costs that would undoubtedly offset much of these savings.²¹

In 2005, a similar study examined whether New Mexico should freeze its DB plan and adopt a DC plan for newly-hired teachers. It found that such a move could "not produce 'same or better' benefits," and that the change would result in either a decrease in retirement benefits, an increase in the plan's total cost, deterioration of the funded position of the frozen DB plan, or some combination of these three scenarios.²²

Conclusion

Considering the costs and complexities of freezing DB plans and switching to DC plans, it is perhaps not surprising that most state and local governments have chosen to retain their pension plans. Although some public employers have had to make the difficult decision to reduce benefits because of tight budgetary constraints, they have generally found that modifying benefits within the existing DB pension framework has been the more cost effective option, rather than freezing the pension plan and instituting a new DC plan.

Certainly, the private sector trend of freezing DB plans and moving to DC plans is an unfortunate trend that has had serious, negative ramifications for many workers' retirement security prospects. The current economic turmoil has magnified this insecurity. Luckily, public sector employers can avoid the same regrettable results for their workforces by exercising caution, and allowing the facts to guide decision-making. In other words, policy makers are wise to look before they

leap, since freezing DB plans and switching to DC plans may carry unintended consequences.

Time and again, states that have carefully studied the issue have concluded that, even in tough economic times, continuing to provide retirement benefits via cost-effective DB plans meets the joint interests of fiscal responsibility for employers/taxpayers and retirement security for employees.

Endnotes

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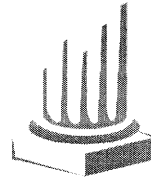
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National Institute on Retirement Security *At-A-Glance*

Overview

The National Institute on Retirement Security is a not-for-profit organization established to contribute to informed policymaking by fostering a deep understanding of the value of retirement security to employees, employers, and the economy. NIRS fulfills this mission by conducting national research and education programs. Located in Washington, D.C., the organization has a diverse membership of organizations interested in retirement security issues such as employee benefit plans, state or local agencies that manage retirement plans, trade associations, financial services firms, and other retirement service providers.

Vision

NIRS seeks to encourage the development of public policies that enhance retirement security in America. Our vision is one of a retirement system that simultaneously meets the needs of employers, employees, and the public interest. That is, one where:

- ❖ employers can offer affordable, high quality retirement benefits that help them achieve their human resources goals;
- ❖ employees can count on a secure source of retirement income that enables them to maintain a decent living standard after a lifetime of work;
- ❖ the public interest is well-served by retirement systems that are managed in ways that promote fiscal responsibility, economic growth, and responsible stewardship of retirement assets.

Approach

High-quality research that informs the public debate on retirement policy. Our research program focuses on the role and value of defined benefit pension plans for employers, employees, and the public at large. We also conduct research on policy approaches and other innovative strategies to expand broad based retirement security.

Education programs that disseminate our research findings broadly. We share our research findings with the public, policy makers, and the media by distributing reports, conducting briefings, and participating in conferences and other public forums.

Outreach to partners and key stakeholders. By building partnerships with other experts in the field of retirement research and with stakeholders that support retirement security, we leverage the impact of our research and education efforts. Our outreach activities also improve the capacity of government agencies, non-profits, the private sector, and others working to promote and expand retirement security.

Leadership

In November 2007, Beth Almeida was named the first executive director of NIRS. With the Board of Directors, Almeida leads the organization's strategic planning, research and education initiatives. During NIRS first full year of operation, she directed the successful completion of six research products that are enhancing the 2American debate on retirement security challenges. She has spoken at numerous conferences from coast-to-coast regarding NIRS research and retirement security issues, and is regularly cited in national, local, trade and international news reports.

Previously, she served as assistant director of strategic resources and as senior economist with the International Association of Machinists and Aerospace Workers where she was instrumental in transitioning some 40,000 airline employees out of terminating or freezing pensions into the IAM's multi-employer defined benefit pension plan. Additionally, she has led research initiatives with the Center for European Integration Studies, the European Institute for Business Administration, and the Center for Industrial Competitiveness. She holds a bachelor's degree in international business from Lehigh University and a master's degree in economics from the University of Massachusetts Amherst.

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Teachers' Retirement System

ALASKA STATE LEGISLATURE

Senator Joe Paskvan

Chair, Labor and Commerce
Vice Chair, Health and Social Services
Member, Transportation
Member, State Affairs
Member, Joint Armed Services



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*Senate District E
Fairbanks and Fort Wainwright*

To: Senator Bert Stedman, Co-Chair
Senate Finance Committee

From: Senator Joe Paskvan

Date: April 1, 2009

Re: Request for Hearing for CS SB 23 (L&C) – Restoring the Defined Benefit Retirement System for Public Employees

I respectfully request Committee Substitute for Senate Bill 23 (L&C) be scheduled for a hearing before the Senate Finance Committee at your earliest convenience.

SB 23 seeks to return guaranteed pensions and retiree healthcare benefits to Alaska teachers, police officers, and firefighters, as well as municipal clerks, certified nurse aides at the Pioneer Homes, and thousands of other hard working public employees.

This important legislation, if passed, will allow people who have spent their working career serving the State of Alaska to retire with dignity.

Included in this packet:

- Sponsor Statement
- All versions of the bill
- Sectional Analysis
- Supporting Documents
- Letters of Support

If you have any questions or comments, please contact Jeff Stepp (465-4747).

Thank you for your consideration.

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Sponsor Statement

SB 23 - Restoring Pension Benefits for Public Employees

SB 23 returns guaranteed pensions and retiree healthcare benefits to Alaska teachers and public employees. It will make it easier to recruit and retain teachers, police officers, firefighters, and other public employees.

Analyses by actuaries and the state Division of Retirement and Benefits show that Alaska's defined benefit pensions - paying a guaranteed monthly benefit plus health care for employees with a long record of service - cost the same as the new defined contribution system but provide much better benefits. With SB 23 Alaskans get more benefit for the same cost, strengthening the 1.5 billion retirees contribute to Alaska's economy. A recent study shows the vast majority of pension benefits paid in Alaska come from the public pension systems.

SB 23 hires new employees in the least expensive pension plans - public employee tier III and teacher tier II - instead of risky individual savings accounts. The state already administers these plans for thousands of members, so no new bureaucracy is needed. The bill also allows new employees who already have a defined benefit pension to choose the high-risk accounts within the first 60 days of employment.

A few years ago, Alaska beefed up oversight of the pension system. Now two actuaries analyze the health of the pension funds, there are more frequent experience studies and the state stopped the practice of sometimes paying less than the cost of benefits. SB 23 keeps these smart reforms, making Alaska pensions stronger than ever.

Without the defined benefit of Social Security, teachers and public employees face excessive risk in individual accounts. On average these accounts earn much less than professionally managed pension funds, and pay higher fees. Worse, the state is now paying some employees to attend investing seminars during work hours - instead of doing their jobs.

The K-12 teachers and university professors who educate our children, the police and firefighters who protect our families, and the public employees who serve our state and cities deserve a secure retirement in return for their service.

I respectfully ask for your support.

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Sectional Analysis, SB 23

Secs. 1 and 2 Clarify that the Teachers Retirement System defined benefit statutes apply only to employees who participate in the DB plan and did not convert to defined contribution. No employees can participate in both the DB and DC plans.

Secs. 3 and 4 Allow the Alaska Retirement Management Board, rather than the plan administrator, to adjust pension payments for inflation when the financial condition of the TRS trust fund permits, by removing the 105 percent funding ratio requirement.

Sec. 5 Clarifies that the TRS DC statutes apply only to employees who participate in the DC plan and did not convert to DB. No employees can participate in both the DB and DC plans.

Sec. 6 Allows a new employee who is already fully vested in a defined benefit retirement plan other than the Alaska Public Employees Retirement System or TRS to make a one-time, irrevocable election to participate in the TRS DC plan. The administrator must provide information and the employee must choose the DC plan within 60 days of hire.

Sec. 7 Clarifies that the PERS DB statutes apply only to employees who participate in the DB plan and did not convert to defined contribution. No employees can participate in both the DB and DC plans.

Sec. 8 Allow the Alaska Retirement Management Board, rather than the plan administrator, to adjust pension payments for inflation when the financial condition of the PERS trust fund permits, by removing the 105 percent funding ratio requirement.

Sec. 9 Allows employers that return to PERS after terminating participation to hire employees the same way other PERS employers do, and allows employees to earn service credits in the appropriate tier when working for those employers.

Sec. 10 Clarifies that the PERS DC statutes apply only to employees who participate in the DC plan and did not convert to DB. No employees can participate in both the DB and DC plans.

Sec. 11 Allows a new employee who is already fully vested in a defined benefit retirement plan other than the Alaska PERS or TRS to make a one-time, irrevocable election to participate in the PERS DC plan. The administrator must provide information and the employee must choose the DC plan within 60 days of hire.

Sec. 12 Repeals sections that let employees convert from DB to DC and require employers to match the funds transferred dollar for dollar. Repeals sections related to political subdivisions that participate only in the DC plan. Repeals a requirement that DB employees who refunded contributions from the system and return to work after July 1, 2010 participate only in the DC plan. (Such employees will be treated as new hires.)

Sec. 13 Gives employees hired into the DC plans who have not refunded out of those plans a 90-day period from the effective date of the bill (or until September 1, 2009, whichever is later) to irrevocably convert into PERS tier III or TRS tier II, as appropriate. It also gives them the opportunity to transfer their contributions from the DC plan to the DB plan if they make the switch.

Sec. 14 Sets for the procedure for the conversion election in Sec. 34 and allows the Alaska Retirement Management Board to adopt regulations related to the conversion. The choice to convert is irrevocable, and certain information must be provided to the employee. Employees who transfer receive credited service in the defined benefit plan equal to the lesser of the employee's actual service or the actuarially calculated value of the employer and employee money transferred from the defined contribution account.

Sec. 15 Allows the Commissioner of Administration to adopt regulations to implement and make specific the bill's provisions.

Sec. 16 is an immediate effective date for sections 14 and 15 of the bill.

Alaska Division of Retirement and Benefits
Teachers' Retirement System (TRS) Plan Comparison Chart

Feature	Tier I July 1, 1955 – June 30, 1990	Tier II Entered on or after July 1, 1990	Tier III Entered on or after July 1, 2006
Employee Contribution	Pre-tax employee contribution: 8.65% beginning 1/1/91	Pre-tax employee contribution: 8.65% beginning 1/1/91	Pre-tax employee contribution: 8% Employee may make additional contributions.
Employer Contribution	Determined by annual actuarial valuation.	Determined by annual actuarial valuation.	7% - DC account 1.75% Health Plan - determined by annual actuarial valuation after FY07. HRA - Flat dollar amount per employee based on 3% of the employer's average annual employee compensation.
Vesting	Members vest with 8 years of service.	Members vest with 8 years of service.	100% vested in employee contributions from inception. Vested in employer contributions based on the following schedule: 25% after 2 years of service, 50% after 3 years, 75% after 4 years and 100% after five years.
Qualifications for Retirement	Normal retirement age is 55, with early retirement at age 50; teachers can retire at any age after 20 years of membership service.	Normal retirement age is 60, with early retirement at age 55; teachers can retire at any age after 20 years of membership service.	None for investment account. Taxes and penalties may apply if withdrawn before age 59 1/2. See requirements for Retirement Medical Coverage.
Benefit Calculation Formula	Benefit formula is 2% for the first 20 years and all years of service prior to July 1, 1990 , 2.5% thereafter. Benefit calculation is determined on the average of the high three contract salaries.	Benefit formula is 2% for the first 20 years, 2.5% thereafter. Benefit calculation is determined on the average of the high three contract salaries.	DC account balance plus investment earnings.
Alaska Cost-of-living Increases (COLA)	An Alaska Cost-of-Living Allowance is payable to benefit recipients who remain domiciled in Alaska after retirement. The allowance is 10% of the base benefit.	An Alaska Cost-of-Living Allowance is payable to benefit recipients 65 or older or disability benefit recipients regardless of age who remain domiciled in Alaska after retirement. The allowance is 10% of the base benefit.	None provided.

More detailed information may be found on the Division website, www.state.ak.us/drb, or in the TRS Information Handbook.
G:/publications/handbooks/trs tier chart.doc (Rev. 3/06)

Feature	Tier I July 1, 1955 – June 30, 1990	Tier II Entered on or after July 1, 1990	Tier III Entered on or after July 1, 2006
Post Retirement Pension Adjustments (PRPA) (Inflation protection)	PRPA increases granted on an ad hoc basis. If an ad hoc is not granted, tier I employees must be age 60 or over or receiving benefits for 8 years to qualify for the automatic PRPA. The automatic PRPA legislated in 1990 applied to all members regardless of hire date.	Automatic PRPA adjustments to disabled members, retirees 60 and over, and those who have received benefits for 8 years.	None provided.
Retirement Medical Coverage	Medical coverage is provided to all benefit recipients and their eligible dependents. The retiree medical plan premium is paid by the retirement system.	The retirement system pays the retiree medical plan premium for all disabilitants regardless of age, for retirees and survivors over age 60 and for retirees with at least 25 years of membership service. This coverage includes eligible dependents. Retirees and survivors under age 60, with less than 25 years of membership service must pay the full premium cost if they want coverage.	<p>Access to medical coverage at Medicare eligible age with 10 years of service or at any age with 30 years of service. Must retire directly from the system. If not eligible for Medicare, must pay full premium. May use health reimbursement arrangement (HRA) account to pay premiums. Once the HRA is exhausted, member self- pays premiums.</p> <p>When eligible for Medicare, the percentage of premium paid by the retiree or surviving spouse is:</p> <p>10-14 years of service - 30% 15-19 years - 25% 20-24 years - 20% 25-29 years - 15% 30 years or more - 10%</p>
Disability Benefits	Disability benefits are 50% of base salary, plus 10% for each eligible dependent child up to a maximum of 4 children.	Disability benefits are 50% of base salary, plus 10% for each eligible dependent child up to a maximum of 4 children.	<p>Must be a total and presumably permanent disability whose cause is directly related to performance of duties of the job or an on the job injury. Benefit is 40% of salary, earns service while on occupational disability. Employer continues to make all required contributions as if the member were working, plus the member's required contributions to the DC account, without deduction from the member's disability payment.</p> <p>Disability benefits cease when the member becomes eligible for normal retirement at Medicare eligible age and 10 years of service or at any age with 30 years of service. No medical insurance until eligible for normal retirement.</p>

More detailed information may be found on the Division website, www.state.ak.us/drb, or in the TRS Information Handbook.
G:/publications/handbooks/trs tier chart.doc (Rev. 3/06)

Normal Cost

Employer Normal Cost Rate	PERS Pension	PERS Medical	PERS Total	# of Members ¹
Tier 1 (DB)±	9.15%	10.46%	19.61%	27,561
Tier 2 (DB) ±	5.33%	10.41%	15.74%	16,331
Tier 3 (DB)‡	2.97%	7.98%	10.95%	27,466
Tier 4 (DC)‡	5.38%	3.85%	9.23%	9,211

¹ DRB data dated February, 2009

Employer Normal Cost Rate	TRS Pension	TRS Medical	TRS Total	# of Members ²
Tier 1 (DB)±	7.18%	8.02%	15.20%	11,615
Tier 2 (DB)‡	2.71%	6.25%	8.96%	9,782
Tier 3 (DC)‡	7.32%	4.08%	11.40%	2,415

± rates per Buck Consultants letter March, 2007

² DRB data dated February, 2009

‡ rates per Buck Consultants letter February, 2009

Accrued Liability³

Accrued Liability (DB)	PERS Pension	PERS Medical	PERS Total	TRS Pension	TRS Medical	TRS Total
Tier 1	\$5,628,778	\$4,036,751	\$9,665,530	\$3,925,023	\$1,816,223	\$5,741,247
Tier 2	1,123,559	1,334,674	2,458,233	409,562	347,748	757,309
Tier 3	334,854	386,224	721,078	N/A	N/A	N/A
Total	\$7,087,191	\$5,757,650	\$12,844,841	\$4,334,585	\$2,163,971	\$6,498,556
Assets ^o			\$8,442,919			\$3,958,939
Accrued Liability			\$4,401,922			\$2,539,617

³ per Buck Consultants letter, March 2007

^oPERS DB net assets as of 6/30/2008 were \$10,726,913,000.

TRS DB net assets as of 6/30/2008 were \$4,804,371,000.

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Changes in SB 23

The Labor & Commerce Committee CS makes the following changes to the bill:

- A new teacher or public employee who is fully vested in a defined benefit retirement plan other than PERS or TRS may choose to enter the Defined Contribution Retirement Plan. (bill sections 6 & 11)
 - An employer must give eligible new hires information about the choice within five days of hire.
 - The new employee must choose the DCRP within 60 days of hire.
- The DCRP as a whole is not repealed.
- Certain parts of the DCRP are still repealed (bill section 12), including:
 - Sections in both TRS and PERS allowing non-vested Defined Benefit Retirement Plan employees to transfer to the DCRP and requiring employers to match the employee's contribution dollar-for-dollar.
 - Sections in both TRS and PERS relating to DB employees who work for political subdivisions of the state that participate only in the DCRP.
 - Session law applying to both TRS and PERS limiting employees who refunded their DB contributions and return to work after July 1, 2010 to participation in the DCRP.
 - Language limiting PERS employers who left the PERS system to participation only in the DCRP upon return. (bill section 9)
- Several statutes are amended or repealed and reenacted to account for the fact that some employees will accrue benefits under the DB statutes, while others will accrue benefits under the DCRP statutes. (bill sections 1,2,5,7, 10)



Anchorage Firefighters Local 1264



P.O. Box 242041 • Anchorage, AK 99524-2041
(907) 349-1264 • (907) 349-5580 (fax)

February 4, 2009

Senator Kim Elton
State Capitol Room 506
Juneau, Alaska 99801-1182

Re: SB 23

Sen. Elton,

The International Association of Fire Fighters (IAFF) Local 1264, based in Anchorage, Alaska strongly recommends that the 26th Alaska Legislature work to reinstate a Defined Benefit (DB) pension plan for all new PERS employees.

It costs approximately \$100,000 to recruit, train, and equip entry level Fire Fighters and Paramedics in Anchorage. Unlike other professions where freedom to move from employer to employer may be an attractive quality, employee retention in public safety is paramount to providing quality emergency service. The current PERS Tier IV retirement system provides no stability for new employees, and actually encourages them to move on after gaining five years of valuable "street time" and numerous professional certifications, all at local taxpayer expense.

On a broader macroeconomic scale, 401(k) style retirement plans have proven to be an inadequate means of providing post-employment security to workers. Fire fighters do not participate in Social Security, and even those who have achieved sufficient quarters to qualify for payouts prior to their fire service careers see greatly reduced benefits due to the Windfall Elimination Provision. As recent market events have shown, even diligent retirement planning does not necessarily result in adequate retirement income. By taking away the Defined Benefit pension as well as any social security income, PERS Tier IV members stand to become a greater burden on our future economy when their savings runs out.

The bottom line is that Alaska public safety entities are no longer competitive when it comes to attracting the best new workers. Until pay and benefits are once again similar to other states, there will also be retention problems. We urge you to pass legislation this year to solve this problem and ensure that future generations of Alaskans receive the public safety that they deserve.

Sincerely,

A handwritten signature in black ink that reads 'Tom Wescott'.

Tom Wescott
President IAFF Local 1264

Doug Molyneaux

Residence Address:

7711 Highlander Drive
Anchorage, AK 99518
868-3118

Mailing Address:

P.O. Box 233624
Anchorage, AK 99523

Issue: Testimony for SB 23 in Senate Labor and Commerce on 19 February 2009

Mr. Chairman, committee members, my name is Doug Molyneaux. I have been a fishery biologist with the Alaska Department of Fish and Game since 1981, though my testimony today is my own opinion. I am also a member of the Supervisor Unit of the Alaska Public Employees Association.

Since 1989 my work has focused on Kuskokwim Area salmon fisheries. The Area supports one of the largest subsistence fisheries in the State; accounting for half the annual subsistence harvest of Chinook salmon in Alaska. The Area also supports commercial salmon fisheries, which are poised to expand with the development of a new fish processing plant. Kuskokwim salmon are also caught as bycatch in the lucrative Bering Sea Pollock Fishery, and concern over that bycatch threatens costly restrictions on the pollock fishery.

We have developed a quality salmon monitoring program that is allowing us to emerge from a period of precautionary management to better optimize commercial harvest and avoid unnecessary restrictions. Our ability to implement and maintain that program, however, is at risk because of difficulty in recruitment of staff with needed expertise, and retention of staff to build and maintain the institutional knowledge needed for long-term effectiveness and for building public trust.

There are multiple reasons for the recruitment and retention problem, but a big one is Tier IV, which fails to provide a guaranteed pension for new employees. The recent plummeting of investment values under Tier IV makes that shortfall all the more poignant. One common retention scenario is for us to hire someone, increasingly a non-resident, provide him or her with training, and after a few years they move to a more lucrative federal or private sector job.

Recruitment is also a problem. In just the past few months key positions such as the Regional Supervisor for the Arctic-Yukon-Kuskokwim Region, Yukon Area Research Biologist, multiple biometrician positions, and Fishery Scientist positions have all had recruitment periods spanning months with multiple extensions and nation-wide advertisement, and still we get insufficient hiring pools. From my observation, the problem has worsened since Tier IV.

New and prospective employees are just not satisfied with what the State of Alaska is offering. Tier IV is not the only problem, but it is a big part of the problem, and it is a problem you can do something about. I ask that you take action by reverting to a Defined Benefits Program similar to PERS Tier III.

Backup Addendum:

I qualify for retirement, but I do not see anyone in the wings interested in taking my place. I fear the States' investment in me over the past 20+ years is going to erode away. One of the consequences is that fishery management will be forced to precautionary practices that limit economic opportunity and results in unnecessary restrictions to the public we serve.

Public Safety Employees Association, Inc.
“Representing Alaska’s Finest”

**Public Safety Employees Association Position Paper
Supporting SB 23**

The Public Safety Employees Association is pleased to support SB 23 by Senators Elton, Ellis, French, Wielechowski, Menard, Paskvan, McGuire, Thomas, and Davis. The bill will give PERS and TRS employees hired after July 1, 2006, the option of leaving the defined contribution plan and enter the defined benefit plan. New employees will become members of the defined benefit plan after the effective date of the statute, should SB 23 become law.

Currently the Department of Public Safety struggles to hire enough new troopers to raise the Alaska State Troopers to full strength. Many municipal police departments experience similar difficulties. As more laws are enacted to curb crime, the State of Alaska must hire the necessary number of public safety employees to insure that laws are enforced. Increased crimes involving gangs, drugs, and the internet are added to more conventional crimes involving violence, larceny, burglary, traffic and theft violations. The public will be safer when public safety is at full strength.

While hiring the most qualified and prepared prospects for careers in public safety is important, encouraging those public safety officers to continue their careers is equally important. One valuable tool that the State of Alaska has historically used to both retain and attract persons to positions as peace officers has been the retirement system. Realizing that Public Safety must compete with other states, other police departments and private security firms for officers, the defined benefit retirement system has served as a valuable recruiting tool. Restoring that benefit program will help recruiting.

The defined benefit retirement program has been a valuable retention tool for police officers. Each year of work means increased retirement. We are now concerned that the defined contribution plan may actually encourage shorter lengths of service by officers in Alaska. The retirement system for those hired since July 1, 2006, will accommodate an officer who becomes trained in Alaska, acquires experience in Alaska, establishes a 401K type savings account and decides to take full advantage of the portability of the retirement plan and leave our state for another – especially one with a defined benefit plan. Not only will the police officer take his or her 401K but, they will also take valuable training and experience with them.

As our experience drains to other states, Alaska will find itself investing more training dollars than necessary to offset personnel losses. Restoring a retirement program that is an incentive for recruitment and an encouragement for continued service is good public policy. Such a program is a prescription for improved public safety and greater peace of mind by those who depend on the men and women of public safety to keep their communities safe.

PSEA encourages passage of SB 23.



Retired Public Employees of Alaska, APEA/AFT
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Email: rpea@alaska.net
Web site: www.rpea.apea-aft.org

Jesse

February 3, 2009

Dear Senator Elton,

On behalf of the Retired Public Employees of Alaska (RPEA) we thank you for sponsoring SB 23 to provide a defined benefit retirement plan for public employees. RPEA is a volunteer organization made up of 2,226 retired public employee members.

RPEA believes Alaska's public employees should be covered by a defined benefit retirement plan that helps public employees continue to live in Alaska after they retire. There are no cost of living incentives in the current defined contribution plan for public employees to stay and contribute to Alaska after they retire. We appreciate your sponsorship of legislation to return public employees to the former defined benefits retirement plan would provide a 10% Alaska cost of living allowance, and post retirement pension adjustment to offset inflation.

As you know, Alaska's retired public employees make a significant contribution to Alaska's economy. According to a September 2006 study by the University of Alaska's Institute of Social and Economic Research¹, 23% of Alaska's retirement population are public employee retirees. The study found that in 2004 all of Alaska's retirees brought an estimated \$1.46 billion into the state that was "roughly equal to what fisherman were paid in 2005 for their Alaska seafood harvests, or the value of zinc, gold, and other metals mined in Alaska in 2004."

¹ Sept. 2006, UA Research Summary No. 7, "\$1.5 Billion A Year and Growing: Economic Contributions of Older Alaskans", by Scott Goldsmith and Jane Angvik

Alaskans who live to age 65 must be prepared financially for a long time in retirement. Twenty-nine percent of women who reach age 65 will reach age 90. Eighteen percent of men who reach age 65 will also reach age 90. With no Post Retirement Pension Adjustment to help offset inflation, and no Cost-of-Living Allowance for living in Alaska, retired public employees face significant financial pressure to relocate to states with lower costs of living. Alaska's public employees should be encouraged to live out their retirement years in Alaska and not relocate to some other state or country that would reap the economic benefits of their retirement investments.

We appreciate your leadership on this important issue.

Sincerely, Bob Doll

A handwritten signature in black ink, appearing to read 'Bob Doll', with a large, stylized flourish at the end.

RPEA President



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February 9, 2009

The Honorable Joe Paskvan, Chair
Senate Labor and Commerce Committee
Alaska State Capitol, Room 7
Juneau, AK 99801-1182

RE: SB 23 (Elton)--Support

Dear Chair Paskvan:

On behalf of the members of AARP in Alaska, we encourage you and your colleagues on the Senate Labor and Commerce Committee to support SB 23, authored by Senator Kim Elton and co-sponsored by Senators Ellis, French, Menard, Thomas, McGuire, Davis, Wielechowski and you.

Lifetime financial security is a cornerstone of the American dream: if you work hard and follow the rules, you will be able to retire without financial worries. For most Alaskans, Social Security forms the base of a secure retirement and it is augmented by pensions, IRA's, 401-K's and savings. However few of our teachers or state and municipal employees participate in Social Security. Our defined benefit pensions under TRS and PERS were a stable substitute for Social Security. You cannot outlive Social Security. You cannot outlive a defined benefit pension.

Alaskans who make it to 65 have to prepare financially for a long time in retirement. Of all the women who reach age 65, 29% will also reach age 90. Eighteen percent of men who reach age 65 will also reach age 90.

Our newly hired public employees will only have the defined contribution plan. What will Alaska do with retired teachers, police officers and firefighters who outlive their contributions and have no defined benefit plan under PERS or TRS and do not participate in Social Security?

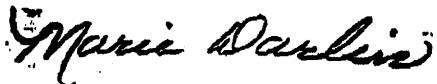
SB 23 will return to a system that will provide reasonable pension benefits that cannot be outlived.

We urge an "AYE" vote on SB 23.

Should you have any questions about our position, please feel free to contact me (586-3637) or Patrick Luby, AARP Advocacy Director (907-762-3314).

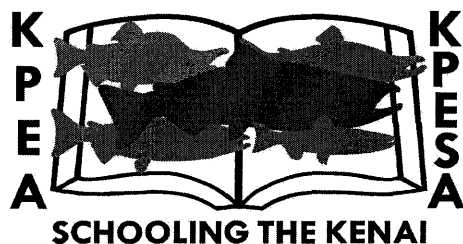
Thank you for your consideration.

Sincerely,



Marie Darlin, Coordinator
AARP Capital City Task Force
415 Willoughby Avenue, Apt. 506
Juneau, AK 99801
586-3637 (voice)
463-3580 (fax)

CC: Vice-Chair Joe Thomas
Senator Bettye Davis
Senator Kevin Meyer
Senator Con Bunde
Senator Kim Elton



Kenai Peninsula Education Association
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ldruce@kpbsd.k12.ak.us

February 13, 2009

RE: Testimony in favor of Senate Bill 23

To: The Honorable Joe Paskvan Chair of the Senate Labor and Commerce Committee

Dear Senator Paskvan and Members of the Senate Labor and Commerce Committee. I am submitting this testimony in favor of Senate Bill 23- Restoring Pension Benefits for Public Employees. As President of The Kenai Peninsula Education Association, I represent over 650 teachers. Many are in Tier I TRS, many in Tier II TRS, and some very unfortunate teachers are in the Tier III Defined Contribution system.

I listened to the hearing on February 12 as Senator Kim Elton gave a synopsis of the history of SB 141 and presented several compelling reasons for the legislature to return to a DB plan for teachers and public employees. I also was interested in the testimony offered by Michael Lamb of the North Star Borough. Both gentlemen mentioned that the "unfunded liability" argument is not relevant to the issue. This has been the phrase said time and time again by those who supported the decision to dismantle the retirement system in the state.

On December 13, 2008 KPEA along with our state organization NEA-AK and our pension coalition partners including the Central Peninsula Labor Council hosted a pension coalition community dialogue forum at Soldotna High

School. Over 50 people representing all Tiers of PERS and TRS were at the forum. All of our local state representatives were invited to attend. Representative Paul Seaton was the only legislator at the forum. Recruiting and just as importantly retaining public employees and teachers were mentioned several times. One participant characterized the new DC system as a "drive by" retirement system. In other words, the new program encourages employees to take their money and run. Run to states where a defined retirement is offered for their future financial security.

Senator Elton mentioned two states, Nebraska and West Virginia, where they had returned to a DB plan after having instituted a DC plan. My suggestion would be the legislators who voted for SB 141 look at this as a "failed experiment" and return Alaska to a defined benefit retirement system before it is too late.

Please vote to move this bill out of committee.

Thank you for your time and efforts in sponsoring and supporting this critical piece of legislation.

Sincerely,

LaDawn Druce

LaDawn Druce
President of the Kenai Peninsula Education Association

- I am submitting written testimony because I am in contract negotiations on February 19, 2009.



Alaska State Legislature

Please enter into the record my testimony to the ___Senate Labor and Commerce Committee on _____SB23 _____, dated 021909_____.

Please accept the following as written testimony from
Joanne Frey
PO Box 1688
Seward AK 99664

Signed: _____Kenai LIO_____

I started teaching in Alaska 2006/07 school year, when the new tier was enacted.

I chose Alaska because I had visited my sister when her husband died and I fell in love (2003)! When hurricane Katrina hit I lost my home and was temporarily out of work! I stayed in Louisiana for 10 months after the storm, but realized early on that "normal" would never return! My history was gone! Every home I ever lived in, every school I attended, every doctor I ever went to...all were gone! I had no records that I even existed left in the city in which my family lived since 1865.

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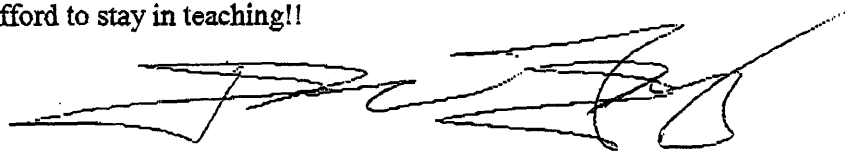
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I also have 20 years business experience for which I am eligibile for social security, but because I am a teacher, I will get very little, if any. You now have a double whammy for teachers and other public employees on this plan.

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Joanne Frey
Ma Ed Intensive Needs
Seward Elementary



Sen. Joe Paskvan

From: Sam Harbo [sjharbo@yahoo.com]
Sent: Thursday, February 26, 2009 8:23 AM
To: Pat Abney; john alacantha; barb angaiak; Jesse Kiehl; Kendra Kloster; barbara rich; Tom Richards; Kristina Ingrid Tornqvist; sam trivette
Cc: willie anderson; Keri Clark; Bob Deitrick; Larry Ehnert; jill exe; Charles Gallagher; lydia garcia; Don Gray; Donald Hadley; Judith A DOR Hall; Don Oberg; siobhan ohara; Tim Parker; Sen. Joe Paskvan; Jerry Patterson; Robb Salo; Susan A Stitham; Sen. Joe Thomas; Judith M Tolbert; Larry Weiss; Kevin T DOA Worley
Subject: Economic Impact of Pension Plans

Hi - A just released publication by the National Institute of Retirement Security is available on the website: www.nirsonline.com. Titled: Pensionomics: Measuring the Economic Impact of State and Local Pensions, it validates the stabilizing effect of DB pensions and the fact that 80% of the funding of these plans comes from investment earnings and employee contributions and only 20% from the taxpayer. In Alaska, because health care is provided to Tier I and II TRS retirees, additional dollars are spent in the community from insurance payments from the state provider and Medicare. This is documented in a publication put out by the state a couple of years ago. Please go to the website to access the document or if you just want state specific data, click on the map for a particular state. For a short time you can hear a digital replay of the teleconference held this morning by calling 1-800-475-6701 and using the access code 988166. I hope you find this information useful. Thanks. Gayle Harbo, NEA-Alaska/Retired

Doug Molyneaux

Residence Address:

7711 Highlander Drive
Anchorage, AK 99518
868-3118

Mailing Address:

P.O. Box 233624
Anchorage, AK 99523

Issue: Testimony for SB 23 in Senate Labor and Commerce on 19 February 2009

Mr. Chairman, committee members, my name is Doug Molyneaux. I have been a fishery biologist with the Alaska Department of Fish and Game since 1981, though my testimony today is my own opinion. I am also a member of the Supervisor Unit of the Alaska Public Employees Association.

Since 1989 my work has focused on Kuskokwim Area salmon fisheries. The Area supports one of the largest subsistence fisheries in the State; accounting for half the annual subsistence harvest of Chinook salmon in Alaska. The Area also supports commercial salmon fisheries, which are poised to expand with the development of a new fish processing plant. Kuskokwim salmon are also caught as bycatch in the lucrative Bering Sea Pollock Fishery, and concern over that bycatch threatens costly restrictions on the pollock fishery.

We have developed a quality salmon monitoring program that is allowing us to emerge from a period of precautionary management to better optimize commercial harvest and avoid unnecessary restrictions. Our ability to implement and maintain that program, however, is at risk because of difficulty in recruitment of staff with needed expertise, and retention of staff to build and maintain the institutional knowledge needed for long-term effectiveness and for building public trust.

There are multiple reasons for the recruitment and retention problem, but a big one is Tier IV, which fails to provide a guaranteed pension for new employees. The recent plummeting of investment values under Tier IV makes that shortfall all the more poignant. One common retention scenario is for us to hire someone, increasingly a non-resident, provide him or her with training, and after a few years they move to a more lucrative federal or private sector job.

Recruitment is also a problem. In just the past few months key positions such as the Regional Supervisor for the Arctic-Yukon-Kuskokwim Region, Yukon Area Research Biologist, multiple biometrician positions, and Fishery Scientist positions have all had recruitment periods spanning months with multiple extensions and nation-wide advertisement, and still we get insufficient hiring pools. From my observation, the problem has worsened since Tier IV.

New and prospective employees are just not satisfied with what the State of Alaska is offering. Tier IV is not the only problem, but it is a big part of the problem, and it is a problem you can do something about. I ask that you take action by reverting to a Defined Benefits Program similar to PERS Tier III.

Backup Addendum:

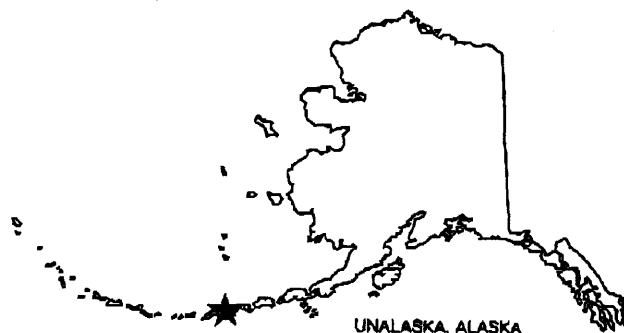
I qualify for retirement, but I do not see anyone in the wings interested in taking my place. I fear the States' investment in me over the past 20+ years is going to erode away. One of the consequences is that fishery management will be forced to precautionary practices that limit economic opportunity and results in unnecessary restrictions to the public we serve.

CITY OF UNALASKA

P.O. BOX 610

UNALASKA, ALASKA 99685-0610
(907) 581-1260 FAX (907) 581-2187

April 7, 2009



Dear Alaska State Legislator:

I am writing to voice my strong support for Senate Bill 23 and House Bill 54: "Pension Benefits for Public Employees".

As a 21-year contributor to the Public Employees Retirement System, I have witnessed first hand the advantages of providing a strong retirement benefit to attract new employees. Having guaranteed pension and health care benefits has helped me to retain high quality employees for extended periods of time.

I have watched with great concern, since the new defined contribution system went into effect, a turnover of new staff in other Departments within our City and wondered what effect the defined contribution system would have on our Water and Wastewater Utility.

With the expected and near term retirement of some of our senior Water and Wastewater staff, I am greatly encouraged to see this important legislation introduced. I look forward to informing new and prospective employees of the positive impact that a long-term employment commitment to our Utility can have on their retirement.

I encourage all legislators to support Senate Bill 23 and House Bill 54.

Thank you,

Clint Huling
Water & Wastewater Supervisor
City of Unalaska
PO Box 610
Unalaska, AK 99685Ph (907) 581-1260
Fax (907) 581-6210

SB23

with file

adn.com

Anchorage Daily News

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Our view: Retirement options**State should let workers choose defined benefit or 401(k)**

(02/21/09 23:03:06)

It's time to let Alaska teachers and state employees choose their retirement plans -- defined benefit or defined contribution. It's time to rectify the panic of 2005.

That's when lawmakers, stricken by a state pension liability of more than \$5 billion, threw the state's defined benefits program overboard and gave employees a defined contribution plan. Instead of a constitutionally guaranteed pension, the state now contributes to a 401(k)-style system, where employees manage their own retirement investments. When they retire, they have to live on their own investment results, whatever they are.

In other words, no guarantees. And since state employees are not included in the federal Social Security system, that was a sobering change.

The idea was to keep the state from amassing huge future pension liabilities. Further privatizing Social Security and pensions was all the rage a few years ago (at then-Sen. Ben Stevens' request, the White House called some state lawmakers to gain support for the change.) Some in the Legislature had their own agendas -- striking a blow against state employee unions.

The result?

Alaska is having trouble recruiting and retaining enough good public employees and teachers. The current market tumble has hit individuals with 401(k) type accounts harder than those with defined benefit plans, exposing the downside of do-it-yourself financial management.

Meanwhile the state has found more effective ways to ease its unfunded liability.

In 2005 a sky-is-falling mentality about the pension liability aided the rush to get rid of defined benefits. Then-Rep. Eric Croft tried to restore sense with a floor speech that likened the panic to a homeowner rushing up to his wife and crying that we owe \$200,000 on our house. Honey, what'll we do?!

Settle down. Pay the mortgage, month by month. The bank isn't going to call your note. Don't panic, just keep working.

For sure Alaska could not afford to keep paying the retirement and health benefits enjoyed by workers who started in the 1970s and '80s, when the state had to compete with the wages and benefits of pipeline and oil boom days. So Alaska scaled back benefits for new hires, not once but twice. As time goes on, there will be fewer retirees collecting those generous benefits from a generation ago.

And in recent years Alaska has used some of its surplus oil revenue to pay down its liability.

Turns out that Rep. Mike Hawker, one of three House sponsors of restoring a state pension system,

was right four years ago. He said then that the state's liability was manageable, that the switch to defined contribution was unnecessary.

Since then, a bipartisan range of sponsors in both the House (10) and Senate (9) has come to believe that the pension system the state eliminated was reasonable, sustainable and, if restored, probably won't cost the state any more than the current system.

Let's give state workers the choice. Those who prefer the portability of a 401(k)-style retirement plan can have it.

Those who want to make a career here can have the solid promise of a pension when they retire.

BOTTOM LINE: Defined benefit pension is a stronger promise for our teachers, troopers and other public employees -- and one we can afford. Let them choose.

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Jeff Stepp

From: tparker@mosquionet.com
Sent: Tuesday, February 10, 2009 8:34 AM
To: Sen. Joe Paskvan
Subject: SB 23

Dear Sen. Joe Paskvan,

Thank you so much for attending the Defined Benefit Forum held in early December at Hering Auditorium. It was great to talk to you, and I hope you gathered some helpful information. I see that SB 23 is up for consideration in the Labor and Commerce Committee on Thursday, and of course I'm urging your support. The defined contribution system does not work and is damaging the education system by an increased amount every year. Many moderate Republicans, including Sue Hull were in favor of the switch three years ago, but because of the damage, they have become supporters of a change back to DB. The cost of running the two systems is very close. What should have happened three years ago was a "fix" to the medical benefits associated with TRS. That was the only broken piece of the retirement plan. Of course, the mistakes made by Mercer confounded the problem, but to a certain degree the state bears some responsibility for this because it allowed member groups to lower the amount contributed by the employer during the late 1990s and even into the early 2000s.

SB 23 has three committees attached this year. Your committee is the first hurdle, and I have high hopes that you will look at this bill very closely and put the work into it so that it can move through the system to an eventual passage during this session.

If there is anything I can do to assist, please let me know. Not only am I the vice president of NEA-Alaska, but I'm also an English teacher at Lathrop High School, and one of your biggest fans (both on and off the golf course).

Sincerely,

Tim Parker
Lathrop High School English teacher
Vice president, NEA-Alaska

Jeff Stepp

From: lloydfam@gci.net
Sent: Tuesday, February 10, 2009 12:12 PM
To: Sen. Joe Paskvan
Subject: HB 23

This email is to ask you to sponsor HB 23 and return to public employees a secure retirement after years of service to the State of Alaska.

I work for the Anchorage School District as an Occupational Therapist and see how difficult it is to recruit new teachers and therapists to come and work in this wonderful state. I have seen other employers scoop up therapists because the benefits are more desirable and affordable. I am fearful that new teachers and therapists will work the minimum of 5 years and then take their Tier III and IV monies with them; along with all the training they have taken while they are working.

Again, please consider and support public employees.

thank you.

Pamela Lloyd

Jeff Stepp

From: gregnel [gregnel@alaska.net]
Sent: Tuesday, February 10, 2009 4:30 PM
To: Sen. Joe Paskvan
Subject: SB 23

Dear Senator Paskvan,

I am writing in regard to SB 23. As an educator in my 12th year in the Anchorage School District I have been and remain very concerned about the changes that have been made in TRS over the last few years. As I'm sure you're aware, the new Tier has not met expectations and I believe will end up costing the State far more in the future. The change from a Defined Benefit plan has cost the state new long term employees. New hires are harder and harder to find, primarily because they see no reason to stay. While annual pay may be competitive in some areas for new hires, the retirement package does not provide an incentive to stay. As a result we have people coming and leaving after a year or two. Worse, there are far too many stories of new hires signing contracts in the Spring and not showing up in the fall once they realize with the Defined Contribution actually means. One example of the effect of the Defined Contribution is here in Anchorage where in 25% of the people teaching in Special Education are not certificated Special Educators. This then requires the ASD to spend money to train and retrain them. As well, many positions are going unfilled.

The other failure of the Defined Contribution is in saving the state money. Not only does this new plan not save money it will eventually cost the State more money. As a Tier 2 member, I am planning on retiring here in Alaska. I also plan on living a long time. Now with Tier 3, there is no one back-filling TRS for me, as I am doing for those who've gone before me. So Alaska is now in a situation where the State will be responsible for every Tier 1 and 2 member and their spouse until they day they die. This of course was short-sighted as we ended a semi-self funded retirement plan for one the costs us in the short term by not being able to retain new hires, and in the long term as the State will be required to pick up the costs of every Tier 1 and 2 member's retirement and health costs. Its unlikely that the citizens of Alaska will be overly excited about this prospect.

My final comment is that around the country states that have previously done away with have now reversed themselves and reinstated the Defined Benefit plan. Alaska should not waste time and more money waiting to eventually do the same thing.

Thank you for your time,

Greg Hartlieb



Alaska State Legislature

Please enter into the record my testimony to the ___Senate Labor and Commerce
Committee on ___SB23___, dated 021909_____.

Please accept the following as written testimony from
Joanne Frey
PO Box 1688
Seward AK 99664

Signed: _____Kenai LIO_____

I started teaching in Alaska 2006/07 school year, when the new tier was enacted.

I chose Alaska because I had visited my sister when her husband died and I fell in love (2003)! When hurricane Katrina hit I lost my home and was temporarily out of work! I stayed in Louisiana for 10 months after the storm, but realized early on that "normal" would never return! My history was gone! Every home I ever lived in, every school I attended, every doctor I ever went to...all were gone! I had no records that I even existed left in the city in which my family lived since 1865.

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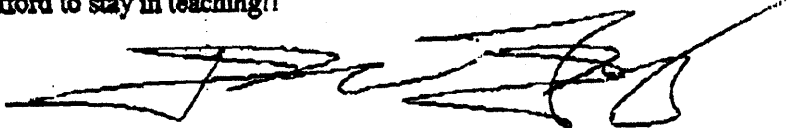
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Joanne Frey
Ma Ed Intensive Needs
Seward Elementary



LEGAL SERVICES

DIVISION OF LEGAL AND RESEARCH SERVICES
LEGISLATIVE AFFAIRS AGENCY
STATE OF ALASKA

(907) 465-3867 or 465-2450
FAX (907) 465-2029
Mail Stop 3101

State Capitol
Juneau, Alaska 99801-1182
Deliveries to: 129 6th St., Rm. 329


MEMORANDUM

February 24, 2009

SUBJECT: Draft CSSB 23(), allowing teachers and public employees a choice between the defined benefit and defined contribution retirement plans (Work Order No. 26-LS0172S)

TO: Senator Joe Paskvan
Attn: Jeff Stepp

FROM: Dan Wayne
Legislative Counsel



Enclosed is the draft CS you requested. Please review it carefully to see that it does all that you wish.

The draft repeals secs. 21 and 94, ch. 9, FSSLA 2005, sections that enact AS 14.25.150(c) and AS 39.35.200(d), effective June 30, 2010. These subsections were adopted in SB 141 to cut off the opportunity of returning state employees to buy back credited service they cashed out when leaving state service prior to 2010. This forfeiture seemed inconsistent with the aims of your bill request. These two statutes, which have a delayed effective date, read as follows:

AS 14.25.150(c) [Effective June 30, 2010]. A member who has received a refund of contributions in accordance with this section forfeits corresponding credited service under AS 14.25.009 - 14.25.220.

AS 39.35.200(d) [Effective June 30, 2010]. An employee who receives a refund of contributions in accordance with this section forfeits corresponding credited service under AS 39.35.095 - 39.35.680.

Consistent with this approach the draft bill also repeals secs. 17 and 81 of ch. 20, SLA 2007, since sections 17 and 81 are delayed amendments, effective in July 2010 (under sec. 119 of ch. 20, SLA 2007) that require former members of PERS/TRS who have cashed out their retirement before July 2010 to participate in the defined contribution plan if they return to work after that date.

The draft also repeals AS 39.35.957(b), which has to do with choices employers make about participation in retirement plans, and would deny certain employees the opportunity to choose between plans.

Note that this draft does not address members of EPORS.

DCW:ljw
09-107.ljw

Enclosure

26-LS0172\S
Wayne
2/24/09

CS FOR SENATE BILL NO. 23()
IN THE LEGISLATURE OF THE STATE OF ALASKA
TWENTY-SIXTH LEGISLATURE - FIRST SESSION

BY

Offered:
Referred:

Sponsor(s): SENATORS ELTON, Ellis, French, Wielechowski, Menard, Paskvan, McGuire, Thomas, Davis

A BILL

FOR AN ACT ENTITLED

1 **"An Act relating to the public employees' retirement system and the teachers'**
2 **retirement system; providing for an effective date by deleting the effective date of secs.**
3 **21 and 94, ch. 9, FSSLA 2005; and providing for an effective date."**

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

5 *** Section 1.** AS 14.25.009 is repealed and reenacted to read:

6 **Sec. 14.25.009. Applicability of AS 14.25.009 - 14.25.220.** The provisions of
7 AS 14.25.009 - 14.25.220 apply to teachers who are eligible to be members of the
8 teachers' retirement system under 14.25.009 - 14.25.220 and are not members of the
9 defined contribution retirement plan under AS 14.25.310 - 14.25.590.

10 *** Sec. 2.** AS 14.25.040(a) is amended to read:

11 (a) Unless a teacher or member participates in a university retirement program
12 under AS 14.40.661 - 14.40.799, has filed an election under AS 14.25.043(b), or has
13 elected under AS 14.25.330 or former AS 14.25.540 to participate in the plan
14 established in AS 14.25.310 - 14.25.590, a teacher or member contracting for service

1 with a participating employer is subject to AS 14.25.009 - 14.25.220.

2 * **Sec. 3.** AS 14.25.143(a), as that subsection read following amendment by sec. 3, ch. 146,
3 SLA 1980, until amended by sec. 12, ch. 106, SLA 1988, as amended by sec. 18, ch. 9,
4 FSSLA 2005, is amended to read:

5 (a) When the **board** [ADMINISTRATOR] determines that the cost of living
6 has increased and that the financial condition of the retirement fund permits, the
7 administrator shall increase benefit payments to persons receiving benefits under this
8 plan. [FOR PURPOSES OF THIS SUBSECTION, THE FINANCIAL CONDITION
9 OF THE FUND WOULD ONLY PERMIT AN INCREASE IN BENEFITS WHEN
10 THE RATIO OF TOTAL FUND ASSETS TO THE ACCRUED LIABILITY MEETS
11 OR EXCEEDS 105 PERCENT. IN THIS SUBSECTION, "ACCRUED LIABILITY"
12 MEANS THE PRESENT VALUE OF ALL MEMBER BENEFITS ACCRUED BY
13 MEMBER SERVICE IN THIS PLAN.]

14 * **Sec. 4.** AS 14.25.143(a), as that subsection read following amendment by sec. 12, ch. 106,
15 SLA 1988, until amended by sec. 12, ch. 97, SLA 1990, as amended by sec. 19, ch. 9, FSSLA
16 2005, is amended to read:

17 (a) When the **board** [ADMINISTRATOR] determines that the cost of living
18 has increased and that the financial condition of the retirement fund permits, the
19 administrator shall increase benefit payments to persons receiving benefits under this
20 plan. [FOR PURPOSES OF THIS SUBSECTION, THE FINANCIAL CONDITION
21 OF THE FUND WOULD ONLY PERMIT AN INCREASE IN BENEFITS WHEN
22 THE RATIO OF TOTAL FUND ASSETS TO THE ACCRUED LIABILITY MEETS
23 OR EXCEEDS 105 PERCENT. IN THIS SUBSECTION, "ACCRUED LIABILITY"
24 MEANS THE PRESENT VALUE OF ALL MEMBER BENEFITS ACCRUED BY
25 MEMBER SERVICE IN THIS PLAN.]

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

27 **Sec. 14.25.310. Applicability of AS 14.25.310 - 14.25.590.** The provisions of
28 AS 14.25.310 - 14.25.590 apply only to teachers

29 (1) who first become members on or after July 1, 2006, **and do not**
30 **transfer to a defined benefit retirement plan under AS 14.25.009 - 14.25.220 or**
31 **AS 39.35.095 - 39.35.680; and**

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(2) described in AS 14.25.330 who elect under that section to become [TO MEMBERS WHO ARE EMPLOYED BY EMPLOYERS THAT DO NOT PARTICIPATE IN THE DEFINED BENEFIT RETIREMENT PLAN ESTABLISHED UNDER AS 14.25.009 - 14.25.220, OR TO] members [WHO TRANSFER INTO THE DEFINED CONTRIBUTION RETIREMENT PLAN UNDER AS 14.25.540].

* **Sec. 6.** AS 14.25.330 is repealed and reenacted to read:

Sec. 14.25.330. Retirement plan election option. (a) A teacher who is first hired on or after the effective date of this section and has not previously been a member of a defined benefit retirement plan or a defined contribution retirement plan under this chapter or AS 39.35 may make a one-time election to participate in the defined contribution retirement plan under AS 14.25.310 - 14.25.590 and transfer employee contributions, if any, and employer contributions, if any, that have been made to the defined benefit retirement plan under AS 14.25.009 - 14.25.220 since the date of hire.

(b) The election to participate in the defined contribution retirement plan under (a) of this section must be made within 60 days after the date of hire, and be made in writing on a form and in the manner prescribed by the administrator. Before accepting an election to participate in the defined contribution retirement plan, the administrator shall, within five days after the teacher's hire, provide the teacher eligible to make an election to participate in the defined contribution retirement plan under AS 14.25.310 - 14.25 590 with

(1) information, including calculations to illustrate the effect of moving the teacher's retirement plan from the defined benefit retirement plan to the defined contribution retirement plan; and

(2) other information to clearly inform the teacher of the potential consequences of the teacher's election.

(c) An election made under (a) of this section to participate in the defined contribution retirement plan is irrevocable. On making the election, the teacher shall be enrolled as a member of the defined contribution retirement plan under AS 14.25.310 - 14.25.590, the member's participation in the plan shall be governed by

1 the provisions for the defined contribution retirement plan, and the member's
2 participation in the defined benefit retirement plan under AS 14.25.009 - 14.25.220
3 shall terminate. The member's enrollment in the defined contribution retirement plan is
4 effective the first day of the month after the administrator receives the completed
5 enrollment forms. An election made by an eligible member who is married is not
6 effective unless the election is signed by the member's spouse.

7 (d) As directed by the member, the Alaska Retirement Management Board
8 shall transfer or cause to be transferred the appropriate amounts to the designated
9 account. The administrator shall credit the member with a service credit that is equal
10 to the member's actual service or the actuarially calculated value of the employer and
11 employee contributions transferred, whichever is less. The board shall establish
12 transfer procedures by regulation, but the actual transfer may not be later than 30 days
13 after the effective date of the member's participation in the defined contribution
14 retirement plan, unless the major financial markets for securities available for a
15 transfer are seriously disrupted by an unforeseen event that also causes the suspension
16 of trading on any national securities exchange in the country where the securities were
17 issued. In that event, the 30-day period of time may be extended by a resolution of the
18 board. Transfers are not commissionable or subject to other fees and may be in the
19 form of securities or cash as determined by the board. Securities shall be valued on the
20 date of receipt in the member's account.

21 * **Sec. 7.** AS 39.35.095 is repealed and reenacted to read:

22 **Sec. 39.35.095. Applicability of AS 39.35.095 - 39.35.680.** The provisions of
23 AS 39.35.095 - 39.35.680 apply to public employees who are eligible to be members
24 of the public employees' retirement system under AS 39.35.095 - 39.35.680 and are
25 not members of the defined contribution retirement plan under AS 39.35.700 -
26 39.35.990.

27 * **Sec. 8.** AS 39.35.475(a), as that subsection read following amendment by sec. 34, ch. 146,
28 SLA 1980, until amended by sec. 41, ch. 82, SLA 1986, as amended by sec. 112, ch. 9,
29 FSSLA 2005, is amended to read:

30 (a) When the **board** [ADMINISTRATOR] determines that the cost of living
31 has increased and that the financial condition of the retirement fund permits, the

1 administrator shall increase benefit payments to persons receiving benefits under this
 2 plan. [FOR PURPOSES OF THIS SUBSECTION, THE FINANCIAL CONDITION
 3 OF THE FUND WOULD ONLY PERMIT AN INCREASE IN BENEFITS WHEN
 4 THE RATIO OF TOTAL FUND ASSETS TO THE ACCRUED LIABILITY MEETS
 5 OR EXCEEDS 105 PERCENT. IN THIS SUBSECTION, "ACCRUED LIABILITY"
 6 MEANS THE PRESENT VALUE OF ALL MEMBER BENEFITS ACCRUED BY
 7 MEMBER SERVICE IN THIS PLAN.]

8 * **Sec. 9.** AS 39.35.620(k) is amended to read:

9 (k) Termination of an employer's participation in the plan does not bar future
 10 participation in the system by that employer if the employer is current with payments
 11 on amounts due under AS 39.35.625. [IF A PREVIOUSLY TERMINATED
 12 EMPLOYER RETURNS TO THE SYSTEM, THE EMPLOYER MAY ONLY
 13 PARTICIPATE IN THE PLAN ESTABLISHED UNDER AS 39.35.700 - 39.35.990.
 14 EMPLOYEES MAY BE CREDITED UNDER AS 39.35.700 - 39.35.990 ONLY
 15 WITH SERVICE SUBSEQUENT TO THE DATE OF RETURN.]

16 * **Sec. 10.** AS 39.35.700 is amended to read:

17 **Sec. 39.35.700. Applicability of AS 39.35.700 - 39.35.990.** The provisions of
 18 AS 39.35.700 - 39.35.990 apply only to

19 (1) members first hired on or after July 1, 2006, who do not transfer
 20 to a defined benefit retirement plan under AS 14.25.009 - 14.25.220 or
 21 AS 39.35.095 - 39.35.680; and

22 (2) public employees described in AS 39.35.720 who elect under
 23 that section to become [TO MEMBERS WHO ARE EMPLOYED BY
 24 EMPLOYERS THAT DO NOT PARTICIPATE IN THE DEFINED BENEFIT
 25 RETIREMENT PLAN ESTABLISHED UNDER AS 39.35.095 - 39.35.680, OR TO]
 26 members [WHO TRANSFER INTO THE DEFINED CONTRIBUTION
 27 RETIREMENT PLAN UNDER AS 39.35.940].

28 * **Sec. 11.** AS 39.35.720 is repealed and reenacted to read:

29 **Sec. 39.35.720. Retirement plan election option.** (a) A public employee who
 30 is first hired on or after the effective date of this section and has not previously been a
 31 member of a defined benefit retirement plan or a defined contribution retirement plan

1 under AS 14.25 or this chapter may make a one-time election to participate in the
2 defined contribution retirement plan under AS 39.35.700 - 39.35.990 and to transfer
3 employee contributions, if any, and employer contributions, if any, that have been
4 made to the defined benefit retirement plan under AS 39.35.095 - 39.35.680.

5 (b) The election to participate in the defined contribution retirement plan
6 under (a) of this section must be made within 60 days after the date of hire, and be
7 made in writing on a form and in the manner prescribed by the administrator. Before
8 accepting an election to participate in the defined contribution retirement plan under
9 AS 39.35.700 - 39.35.990, the administrator shall, within five days after the public
10 employee's hire, provide the employee eligible to make an election to participate in the
11 defined contribution retirement plan with

12 (1) information, including calculations to illustrate the effect of
13 moving the employee's retirement plan from the defined benefit retirement plan to the
14 defined contribution retirement plan; and

15 (2) other information to clearly inform the employee of the potential
16 consequences of the employee's election.

17 (c) An election made under (a) of this section to participate in the defined
18 contribution retirement plan is irrevocable. On making the election, the employee shall
19 be enrolled as a member of the defined contribution retirement plan under
20 AS 39.35.700 - 39.35.990, the member's participation in the plan shall be governed by
21 the provisions for the defined contribution retirement plan, and the member's
22 participation in the defined benefit retirement plan under AS 39.35.095 - 39.35.680
23 shall terminate. The member's enrollment in the defined contribution retirement plan is
24 effective the first day of the month after the administrator receives the completed
25 enrollment forms. An election made by an eligible member who is married is not
26 effective unless the election is signed by the member's spouse.

27 (d) As directed by the member, the Alaska Retirement Management Board
28 shall transfer or cause to be transferred the appropriate amounts to the designated
29 account. The administrator shall credit the member with a service credit that is equal
30 to the member's actual service or the actuarially calculated value of the employer and
31 employee contributions transferred, whichever is less. The board shall establish

1 transfer procedures by regulation, but the actual transfer may not be later than 30 days
2 after the effective date of the member's participation in the defined contribution
3 retirement plan, unless the major financial markets for securities available for a
4 transfer are seriously disrupted by an unforeseen event that also causes the suspension
5 of trading on any national securities exchange in the country where the securities were
6 issued. In that event, the 30-day period of time may be extended by a resolution of the
7 board. Transfers are not commissionable or subject to other fees and may be in the
8 form of securities or cash as determined by the board. Securities shall be valued on the
9 date of receipt in the member's account.

10 * **Sec. 12.** AS 14.25.012(c), 14.25.540; AS 39.35.940, 39.35.957(b); secs. 21 and 94, ch. 9,
11 FSSLA 2005, and secs. 17 and 81, ch. 20, SLA 2007, are repealed.

12 * **Sec. 13.** The uncodified law of the State of Alaska is amended by adding a new section to
13 read:

14 RETIREMENT PLAN ELECTION OPTION. (a) A teacher who was first hired on or
15 after July 1, 2006, and before the effective date of this section and who is a member of the
16 defined contribution plan of the teachers' retirement system under AS 14.25.310 - 14.25.590
17 may make a one-time election before September 1, 2009, or within 90 days after the effective
18 date of this section, whichever is later, to participate in the defined benefit retirement plan
19 under AS 14.25.009 - 14.25.220 and to transfer any contributions, including employer
20 contributions, made to the defined contribution plan before that date.

21 (b) A public employee who was first hired on or after July 1, 2006, and before the
22 effective date of this section and who is a member of the defined contribution plan of the
23 public employees' retirement system under AS 39.35.700 - 39.35.990 may make a one-time
24 election before September 1, 2009, or within 90 days after the effective date of this section,
25 whichever is later, to participate in the defined benefit retirement plan under AS 39.35.095 -
26 39.35.680 and to transfer any contributions, including employer contributions, made to the
27 defined contribution plan before that date.

28 * **Sec. 14.** The uncodified law of the State of Alaska is amended by adding a new section to
29 read:

30 RETIREMENT PLAN ELECTION PROCEDURE; REGULATIONS REQUIRED.

31 (a) The election to participate in the defined benefit retirement plan under sec. 13 of this Act

1 must be made in writing on forms and in the manner prescribed by the administrator. Before
2 accepting an election to participate in the defined benefit retirement plan, the administrator
3 shall provide the employee planning on making an election to participate in the defined
4 benefit retirement plan with information, including calculations to illustrate the effect of
5 moving the employee's retirement plan from the defined contribution retirement plan to the
6 defined benefit retirement plan as well as other information to clearly inform the employee of
7 the potential consequences of the employee's election.

8 (b) An election made under sec. 13 of this Act to participate in the defined benefit
9 retirement plan is irrevocable. On making the election, the participant shall be enrolled as a
10 member of the defined benefit retirement plan, the member's participation in the plan shall be
11 governed by the provisions for the defined benefit retirement plan, and the member's
12 participation in the defined contribution retirement plan shall terminate. The participant's
13 enrollment in the defined benefit retirement plan shall be effective the first day of the month
14 after the administrator receives the completed enrollment forms. An election made by an
15 eligible member who is married is not effective unless the election is signed by the
16 individual's spouse.

17 (c) As directed by the participant, the Alaska Retirement Management Board shall
18 transfer or cause to be transferred the appropriate amounts to the designated account. The
19 administrator shall credit the participant with a service credit that is equal to the participant's
20 actual service or the actuarially calculated value of the employer and employee contribution
21 transferred, whichever is less. The board shall establish transfer procedures by regulation, but
22 the actual transfer may not be later than 30 days after the effective date of the member's
23 participation in the defined benefit retirement plan unless the major financial markets for
24 securities available for a transfer are seriously disrupted by an unforeseen event that also
25 causes the suspension of trading on any national securities exchange in the country where the
26 securities were issued. In that event, the 30-day period of time may be extended by a
27 resolution of the board. Transfers are not commissionable or subject to other fees and may be
28 in the form of securities or cash as determined by the board. Securities shall be valued on the
29 date of receipt in the participant's account.

30 (d) In this section,

31 (1) "administrator" means the person appointed or designated by the

1 commissioner of administration under AS 39.35.050 for a public employees' retirement plan
2 and under AS 14.25.003 for a teachers' retirement plan;

3 (2) "board" means the Alaska Retirement Management Board established
4 under AS 37.10.210;

5 (3) "defined benefit retirement plan" means the retirement plan established
6 under

7 (A) AS 14.25.009 - 14.25.220 for a teacher; or

8 (B) AS 39.35.095 - 39.35.680 for a public employee;

9 (4) "defined contribution retirement plan" means the retirement plan
10 established under

11 (A) AS 14.25.310 - 14.25.590 for a teacher; or

12 (B) AS 39.35.700 - 39.35.990 for a public employee.

13 * **Sec. 15.** The uncodified law of the State of Alaska is amended by adding a new section to
14 read:

15 ADOPTION OF REGULATIONS. The commissioner of administration shall proceed
16 immediately to adopt regulations consistent with this Act, but in no event may the regulations
17 take effect before the effective date of sec. 13 of this Act.

18 * **Sec. 16.** Section 149, ch. 9, FSSLA 2005, is amended to read:

19 Sec. 149. Sections 12, 13, 15, 16, 89 - 93 [21, 89 - 94], 107, 113, and 133 of
20 this Act take effect June 30, 2010.

21 * **Sec. 17.** Sections 14 and 15 of this Act take effect immediately under AS 01.10.070(c).




SENATOR KIM ELTON

MEMORANDUM

February 24, 2009

To: Dan Wayne, Legislative Legal Services

From: Jesse Kieh 

Re: SB 23, the \E version

A couple of tweaks to the E version:

1. The CS should not repeal secs. 21 and 94, ch. 9 FSSLA 2005. The 2010 deadline to buy back cashed out service should remain.
 - a. The repeal of secs. 17 and 81 of ch. 20 SLA 2007 was a great catch, though. Leave that in.
2. The references to "employer contributions" on page 3, lines 14-15, and again at page 6, line 6 should cap the amount of employer contributions transferred to the DCR plan at the DCR rate. That's because the employer share of the normal cost for PERS DB is 10.9%, DC is 9.23% - an employee electing DC on the 60th day shouldn't get the extra 1.67% - that should remain in the DB trust fund.
 - a. For sake of clarity: the employer should not be required to make up the difference if the employer contributions transferred are less than the DC normal cost rate (this is currently the case for TRS.) I don't believe the current language does that, but I wanted to be sure I didn't leave a mistaken impression.

And a couple of questions:

1. At page 4, line 4, we make an employee who transfers to DCR a member of the DCR plan on the first day of the month after the administrator gets the forms. Effectively, new hires are in DB for their first month. At line 10, the administrator must give the employee credit for at least some of the first month (assuming the stock market doesn't crash through the floor in the meantime.) Are there any legal problems with granting service credit in the DCR plan in excess of the time the employee has been a "member?"
2. Sec. 9 of the bill repeals a restriction on terminated PERS employers who return to the system. Is there a comparable restriction in TRS that needs to be addressed?

If possible, Sen. Elton would appreciate a revised blank CS before the close of business Wednesday. Many thanks for your help.

LEGAL SERVICES

DIVISION OF LEGAL AND RESEARCH SERVICES
LEGISLATIVE AFFAIRS AGENCY
STATE OF ALASKA

(907) 465-3867 or 465-2450
FAX (907) 465-2029
Mail Stop 3101


State Capitol
Juneau, Alaska 99801-1182
Deliveries to: 129 6th St., Rm. 329

MEMORANDUM

February 23, 2009

SUBJECT: Draft CSSB 23(), allowing teachers and public employees a choice between the defined benefit and defined contribution retirement plans (Work Order No. 26-LS0172\E)

TO: Senator Kim Elton
Attn: Jesse Kiehl

FROM: Dan Wayne 
Legislative Counsel

Enclosed is the draft CS you requested. Please review it carefully to see that it does all that you wish.

The draft repeals secs. 21 and 94, ch. 9, FSSLA 2005, sections that enact AS 14.25.150(c) and AS 39.35.200(d), effective June 30, 2010. These subsections were adopted in SB 141 to cut off the opportunity of returning state employees to buy back credited service they cashed out when leaving state service prior to 2010. This forfeiture seemed inconsistent with the aims of your bill request. These two statutes, which have a delayed effective date, read as follows:

AS 14.25.150(c) [Effective June 30, 2010]. A member who has received a refund of contributions in accordance with this section forfeits corresponding credited service under AS 14.25.009 - 14.25.220.

AS 39.35.200(d) [Effective June 30, 2010]. An employee who receives a refund of contributions in accordance with this section forfeits corresponding credited service under AS 39.35.095 - 39.35.680.

Consistent with this approach the draft bill also repeals secs. 17 and 81 of ch. 20, SLA 2007, since sections 17 and 81 are delayed amendments, effective in July 2010 (under sec. 119 of ch. 20, SLA 2007) that require former members of PERS/TRS who have cashed out their retirement before July 2010 to participate in the defined contribution plan if they return to work after that date.

The draft also repeals AS 39.35.957(b), which has to do with choices employers make about participation in retirement plans, and would deny certain employees the opportunity to choose between plans.

Note that this draft does not address members of EPORS.

DCW:plm
09-114.plm

Enclosure

**SENATE COMMITTEE REPORT
First Committee of Referral**

DATE: 1/21/09

FURTHER: State Affairs
Finance

Date of 5-Day Notice: 2/5/09
(in accordance with Uniform Rule 23)

DATE TURNED
IN TO OFFICE: 2/26/09

Labor and Commerce Committee considered SENATE BILL NO. 23

SB 23 REPEAL DEFINED CONTRIB RETIREMENT PLANS

"An Act repealing the defined contribution retirement plans for teachers and for public employees; providing a defined benefit retirement plan for teachers and public employees; making conforming amendments; and providing for an effective date."

and recommends:

- be replaced with SCS or CS SB 23 (LTC)
- adopt previous SCS or CS _____ (_____)
- attached amendment(s)
- adopt _____ Letter of Intent
- further referral to _____ Committee

SENATE BILL:	
<input type="checkbox"/>	Same Title
<input checked="" type="checkbox"/>	New Title
<hr/>	
HOUSE BILL:	
<input type="checkbox"/>	Same Title
<input type="checkbox"/>	Technical Title Change
<input type="checkbox"/>	New Title w/ SCR # _____

NEW FISCAL NOTE(S):

Department	Date	Fiscal	Indet.	Zero	FN#
ADM/ORB	2/26	✓			1
fiscal info forthcoming					

PREVIOUS FISCAL NOTE(S):

Department	Date	Fiscal	Indet.	Zero	FN#

APPROPRIATION - no fiscal note

SIGNATURES AND RECOMMENDATIONS:	PRINTED LAST NAME	DO PASS	DO NOT PASS	NO REC	AMEND
<i>K. Meyer</i>	Meyer	X			
<i>John J. Thomas</i>	Thomas	✓			
<i>Bradley Davis</i>	Davis	✓			
<i>Chris Bunker</i>	Bunker			✓	
CHAIR: <i>Joe Parkman</i>	Parkman	X			

Anna Sorensen

From: Denise Kockritz [denisem_alaska@yahoo.com]
Sent: Wednesday, March 04, 2009 3:19 PM
To: Sen. Joe Paskvan
Cc: Denise Kockritz
Subject: Public Opinion Message on SB23

State employees deserve the security of a guaranteed pension and health insurance in retirement.

The Tier IV retirement plan does not ensure an adequate and predictable retirement.

State services suffer when inadequate benefits cause quality employees to seek work elsewhere.

Please SUPPORT SB 23!

This is an email message from "Denise Kockritz" <denisem_alaska@yahoo.com>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: Travis [travis.depew@alaska.gov]
Sent: Monday, March 02, 2009 9:29 AM
To: Sen. Joe Paskvan
Cc: Travis
Subject: Public Opinion Message on SB23

"State employees deserve the security of a guaranteed pension and health insurance in retirement."

"The Tier IV retirement plan does not ensure an adequate and predictable retirement."

"State services suffer when inadequate benefits cause quality employees to seek work elsewhere."

"Please SUPPORT SB 23."

This is an email message from "Travis" <travis.depew@alaska.gov>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: Kelly Marre [kellymarre@hotmail.com]
Sent: Sunday, March 01, 2009 4:48 PM
To: Sen. Joe Paskvan
Cc: Kelly Marre
Subject: Public Opinion Message on SB23

"State employees deserve the security of a guaranteed pension and health insurance in retirement."

"The Tier IV retirement plan does not ensure an adequate and predictable retirement."

"State services suffer when inadequate benefits cause quality employees to seek work elsewhere."

"Please SUPPORT SB 23."

This is an email message from "Kelly Marre" <kellymarre@hotmail.com>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: Derek Monroe [dirk143@msn.com]
Sent: Saturday, February 28, 2009 9:40 AM
To: Sen. Joe Paskvan
Cc: Derek Monroe
Subject: Public Opinion Message on SB23

To the Honorable Senator Joe Paskvan

Greetings,

I am fairly new to state employment in Alaska. I started my current position October 1, 2008. With regards to benefits, there are two items that are definite deal breaker: Tier IV retirement plan and the \$250.00 deductible for medical care. However, to my own disservice I did not do my homework. Had I done my homework I would have choose to stay in my previous position. In my opinion those to items need to be address in order to acquire the best candidate for state employment. I encourage you to support SB 23.

Thank you,
Derek Monroe

This is an email message from "Derek Monroe" <dirk143@msn.com>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: Jennifer McCormick [jennifer.mccormick@alaska.gov]
Sent: Friday, February 27, 2009 3:18 PM
To: Sen. Joe Paskvan
Cc: Jennifer McCormick
Subject: Public Opinion Message on SB23

"State employees deserve the security of a guaranteed pension and health insurance in retirement."

"The Tier IV retirement plan does not ensure an adequate and predictable retirement."

"State services suffer when inadequate benefits cause quality employees to seek work elsewhere."

"Please SUPPORT SB 23."
I don't have a personal e-mail account.

This is an email message from "Jennifer McCormick" <jennifer.mccormick@alaska.gov>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: Kim Pontbriand [nevadared@hotmail.com]
Sent: Friday, February 27, 2009 2:34 PM
To: Sen. Joe Paskvan
Cc: Kim Pontbriand
Subject: Public Opinion Message on SB23

"State employees deserve the security of a guaranteed pension and health insurance in retirement."

"The Tier IV retirement plan does not ensure an adequate and predictable retirement."

"State services suffer when inadequate benefits cause quality employees to seek work elsewhere."

"Please SUPPORT SB 23."

This is an email message from "Kim Pontbriand" <nevadared@hotmail.com>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: Jenny Carpentino [velocityjen@rocketmail.com]
Sent: Friday, February 27, 2009 8:43 AM
To: Sen. Joe Paskvan
Cc: Jenny Carpentino
Subject: Public Opinion Message on SB23

State employees deserve the security of a guaranteed pension and health insurance in retirement.

The Tier IV retirement plan does not ensure an adequate and predictable retirement. State services suffer when inadequate benefits cause quality employees to seek work elsewhere.

"Please SUPPORT SB 23."

This is an email message from "Jenny Carpentino" <velocityjen@rocketmail.com>. Opinions expressed belong to the sender alone.

Anna Sorensen

From: Dominic Demma [akdemmas@mtaonline.net]
Sent: Friday, February 27, 2009 8:32 AM
To: Sen. Joe Paskvan
Cc: Dominic Demma
Subject: Public Opinion Message on SB23

State employees deserve the security of a guaranteed pension and health insurance in retirement.

"The Tier IV retirement plan does not ensure an adequate and predictable retirement."

"State services suffer when inadequate benefits cause quality employees to seek work elsewhere."

"Please SUPPORT SB 23."

This is an email message from "Dominic Demma" <akdemmas@mtaonline.net>. Opinions expressed belong to the sender alone.

Anna Sorensen

From: wendy barrett [wladybug361@aol.com]
Sent: Thursday, February 26, 2009 6:29 PM
To: Sen. Joe Paskvan
Cc: wendy barrett
Subject: Public Opinion Message on SB23

SAVE the defined benefit (Tier III) for new State employees too!!!

This is an email message from "wendy barrett" <wladybug361@aol.com>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: Tim Pedlow [timpedow@yahoo.com]
Sent: Thursday, February 26, 2009 5:39 PM
To: Sen. Joe Paskvan
Cc: Tim Pedlow
Subject: Public Opinion Message on SB23

State employees deserve the security of a guaranteed pension and health insurance in retirement.

The Tier IV retirement plan does not ensure an adequate and predictable retirement. State services suffer when inadequate benefits cause quality employees to seek work elsewhere.

Please SUPPORT SB 23.

Thank You
Sincerely,

Tim Pedlow

This is an email message from "Tim Pedlow" <timpedow@yahoo.com>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: Daniel Fowler [daniel.fowler@alaska.gov]
Sent: Thursday, February 26, 2009 2:54 PM
To: Sen. Joe Paskvan
Cc: Daniel Fowler
Subject: Public Opinion Message on SB23

Please Joe, do the right thing.
I would love to continue working in public service and look out for our communities future, but I need someone to do the same for me.
please support SB 23

This is an email message from "Daniel Fowler" <daniel.fowler@alaska.gov>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: Kevin French [kfrench@gci.net]
Sent: Thursday, February 26, 2009 2:53 PM
To: Sen. Joe Paskvan
Subject: Public Opinion Message on SB23

I have heard from numerous state hiring managers that are having extreme difficulties recruiting good applicants for many/most positions on Workplace AK. In addition, many job seekers I have spoken to do not desire state employment because they realize the retirement system "is not the same", meaning it is too questionable in their minds. This issue undoubtedly creates a significant dilemma for the state in terms of hiring & retaining quality employee's.

Thanks for considering my feedback.

KF

This is an email message from "Kevin French" <kfrench@gci.net>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: Shannon Lewis [shancherie@hotmail.com]
Sent: Thursday, February 26, 2009 2:49 PM
To: Sen. Joe Paskvan
Cc: Shannon Lewis
Subject: Public Opinion Message on SB23

I would like to voice my concern regarding the inadequacies of State benefits. I have known several State employees who have left there jobs due to the lack of benefits they believed they were going to receive upon retirement. The Tier IV retirement plan does not ensure the kind of retirement employees are looking for and expect from their employer. The State once had such a benefit package that prospective employees lined up for a chance to be hired. The pool was so vast that the State was able to pick and choose among the best applicants and could rest assured the employee would remain through retirement.

State employees deserve the security of a guaranteed pension and health insurance in retirement. If the State wants excellent employees and wants to KEEP excellent employees, I feel there must be a repeal of SB 23.

This is an email message from "Shannon Lewis" <shancherie@hotmail.com>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: Tana Stone [tanastone@gmail.com]
Sent: Thursday, February 26, 2009 1:46 PM
To: Sen. Joe Paskvan
Cc: Tana Stone
Subject: Public Opinion Message on SB23

State employees deserve the security of a guaranteed pension and health insurance in retirement.

The Tier IV retirement plan does not ensure an adequate and predictable retirement.

State services suffer when inadequate benefits cause quality employees to seek work elsewhere.

Please SUPPORT SB 23.

Tana Stone

This is an email message from "Tana Stone" <tanastone@gmail.com>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: Shannon Powers [spowers@gci.net]
Sent: Thursday, February 26, 2009 1:46 PM
To: Sen. Joe Paskvan
Cc: Shannon Powers
Subject: Public Opinion Message on SB23

"State employees deserve the security of a guaranteed pension and health insurance in retirement."

"The Tier IV retirement plan does not ensure an adequate and predictable retirement."

"State services suffer when inadequate benefits cause quality employees to seek work elsewhere."

"Please SUPPORT SB 23."

This is an email message from "Shannon Powers" <spowers@gci.net>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: Lorraine Kastner [lorrainekastner@yahoo.com]
Sent: Thursday, February 26, 2009 1:42 PM
To: Sen. Joe Paskvan
Cc: Lorraine Kastner
Subject: Public Opinion Message on SB23

Please support SB 23. Thanks Lorraine Kastner, Right of Way Agent Central.

This is an email message from "Lorraine Kastner" <lorrainekastner@yahoo.com>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: Shelly Showalter [alaskanshelly@hotmail.com]
Sent: Thursday, February 26, 2009 12:56 PM
To: Sen. Joe Paskvan
Cc: Shelly Showalter
Subject: Public Opinion Message on SB23

Dear Joe,

I support going back to the defined benefit program and would ask that you vote in favor of its reinstatement.

Thanks for your valued service.

Shelly

This is an email message from "Shelly Showalter" <alaskanshelly@hotmail.com>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: Dugan Greenwell [alasklad@gmail.com]
Sent: Thursday, February 26, 2009 12:54 PM
To: Sen. Joe Paskvan
Cc: Dugan Greenwell
Subject: Public Opinion Message on SB23

As an Alaskan hired with the State under tier IV, I would like the State to better look after hardworking people who help to make Alaska a better place to live and work. Please support SB23

Dugan Greenwell
p.o.211352 Auke Bay AK
99821

This is an email message from "Dugan Greenwell" <alasklad@gmail.com>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: Paul Pellegrini [andaree@gmail.com]
Sent: Thursday, February 26, 2009 11:05 AM
To: Sen. Joe Paskvan
Cc: Paul Pellegrini
Subject: Public Opinion Message on SB23

Dear Senator Paskvan,
As a employee with Alaska Division of Forestry, it saddens me to see the employee turn over attributed to lack of pay parody and a sub standard retirement package. After gaining a few years of experience and agency sponsored training, we continually lose promising people to other like agencies. SB 23 is a step in the direction to retain these quality employees and I support it.

Sincerely,
Paul Pellegrini
WFRT II
5775 Greenthumb Circle
Homer, Alaska 99603

This is an email message from "Paul Pellegrini" <andaree@gmail.com>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: Tracy A Olson [tracy_olson@hotmail.com]
Sent: Thursday, February 26, 2009 10:59 AM
To: Sen. Joe Paskvan
Cc: Tracy A Olson
Subject: Public Opinion Message on SB23

Sen. Paskvan,
As a new state employee SB 23 is very important to my future. Please support this for all of us.
Thank you so much!

Tracy A Olson
90 Spruce #303
Juneau, AK
99801

This is an email message from "Tracy A Olson" <tracy_olson@hotmail.com>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: Tanderloin Mikell [tan.mikell@alaska.gov]
Sent: Thursday, February 26, 2009 10:56 AM
To: Sen. Joe Paskvan
Cc: Tanderloin Mikell
Subject: Public Opinion Message on SB23

My name is Tan Mikell. My address is 5848 E. Tudor Road. I've work for the State of Alaska for 10 years plus. I have a question. Is it possible for Tier lll to get the benefits that Tier l and ll have? If so, I'm all for Tier lV having the benefits that Tier lll have. Will someone write me back and let me know what they think of this statement.

Tan

This is an email message from "Tanderloin Mikell" <tan.mikell@alaska.gov>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: P.V. Brown-McMillan [thepersonalpoet@hotmail.com]
Sent: Thursday, February 26, 2009 10:50 AM
To: Sen. Joe Paskvan
Cc: P.V. Brown-McMillan
Subject: Public Opinion Message on SB23

"State employees deserve the security of a guaranteed pension and health insurance in retirement."
"The Tier IV retirement plan does not ensure an adequate and predictable retirement."
"State services suffer when inadequate benefits cause quality employees to seek work elsewhere."
"Please SUPPORT SB 23."

Thank You.

This is an email message from "P.V. Brown-McMillan" <thepersonalpoet@hotmail.com>. Opinions expressed belong to the sender alone.

Anna Sorensen

From: stevekm@gci.net
Sent: Thursday, February 26, 2009 10:50 AM
To: Sen. Joe Paskvan; Sen. Joe Thomas
Subject: SB23

Dear Senators Paskvan and Thomas,

I urge you to support SB 23, which seeks to repeal the Defined Contribution Retirement Plan in place of a Defined Benefits Retirement Plan that guarantees new state employees with a pension at retirement. The move to a Defined Contribution Retirement Plan in 2006 was given a chance however I feel it contributes to difficulties with recruitment and retention of employees. I know this is a consideration for me whether to take a full time position with the state. I ask that you right this by supporting SB 23 and moving it out of committee when you meet on Thursday, 26 February.

Respectfully,
Kathi Stevens, concerned voter

Anna Sorensen

From: Patricia A. Gall [patricia.gall@alaska.gov]
Sent: Thursday, February 26, 2009 10:24 AM
To: Sen. Joe Paskvan
Cc: Patricia A. Gall
Subject: Public Opinion Message on SB23

Please support SB23 because as it stands now as being a fairly new state employee I really don't have much of a retirement plan which is not really fair. So please do the best you can for all of the state employees and public employees. Thank you.

This is an email message from "Patricia A. Gall" <patricia.gall@alaska.gov>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: Will Robinson [wrcr7575@gci.net]
Sent: Thursday, February 26, 2009 10:23 AM
To: Sen. Joe Paskvan
Cc: Will Robinson
Subject: Public Opinion Message on SB23

PLEASE REVERCE THE TEIR 4

This is an email message from "Will Robinson" <wrcr7575@gci.net>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: Thomas Jamgochian [jamgochian@gmail.com]
Sent: Thursday, February 26, 2009 10:17 AM
To: Sen. Joe Paskvan
Cc: Thomas Jamgochian
Subject: Public Opinion Message on SB23

Dear Senator Paskvan-

State employees deserve the security of a guaranteed pension and health insurance in retirement.

The Tier IV retirement plan does not ensure an adequate and predictable retirement.

State services suffer when inadequate benefits cause quality employees to seek work elsewhere.

Please SUPPORT SB 23.

Tom Jamgochian
Fairbanks, AK

This is an email message from "Thomas Jamgochian" <jamgochian@gmail.com>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: Elizabeth A. Cline, 14051 E. Mike's Lane, Palmer, AK 99645 [elizabeth_cline@yahoo.com]
Sent: Thursday, February 26, 2009 10:05 AM
To: Sen. Joe Paskvan
Cc: Elizabeth A. Cline, 14051 E. Mike's Lane, Palmer, AK 99645
Subject: Public Opinion Message on SB23

State employees deserve the security of a guaranteed pension and health insurance in retirement."

The Tier IV retirement plan does not ensure an adequate and predictable retirement.

State services suffer when inadequate benefits cause quality employees to seek work elsewhere.

Please SUPPORT SB 23.

This is an email message from "Elizabeth A. Cline, 14051 E. Mike's Lane, Palmer, AK 99645" <elizabeth_cline@yahoo.com>.

Opinions expressed belong to the sender alone.

Anna Sorensen

From: Dennis Ricker [dennis_ricker@yahoo.com]
Sent: Thursday, February 26, 2009 9:54 AM
To: Sen. Joe Paskvan
Cc: Dennis Ricker
Subject: Public Opinion Message on SB23

Senator Paskvan,

Please accept this note in support of SB23.

As a State Worker for over 28 years, I've seen a few changes, and have a few perspectives.

Whether you work for the Gov't or the private sector,...you know how important the "people" are that carry out the work. And how important it is to find, train, and retain experience to either grow the business or perform the public service.

As you know, State Gov't is having a really tough time recruiting and retaining a workforce.

My supervisor retired in November of 2007 and the position was not filled until Jan of 2009,...and even then there was only 1 viable candidate.

Qualified folks from other agencies (Wildland Fire Professionals from US Forest Service, Bureau of Land Management) were interested until they looked into the wages and benefits. Soon after they gathered the details,...they dropped out. This is after a classification study had been accomplished and the position had been upgraded. We are "really behind".

Most people that work for a gov't agency don't expect that they are going to get a high salary,...but they do expect that they will make a "fair" wage,...and receive a secure job with good benefits,...that's the trade-off.

Well, unfortunately we don't have either a fair wage OR the benefit package.

Please support the passage of SB 23. Help us carry out the "people's work" in an efficient manner with a productive workforce.

--Dennis Ricker
5691 Raspberry Loop
Wasilla, Alaska 99654
Registered Republican
907-376-6544

This is an email message from "Dennis Ricker" <dennis_ricker@yahoo.com>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: Sue Goodglick [nukasue@yahoo.com]
Sent: Thursday, February 26, 2009 9:36 AM
To: Sen. Joe Paskvan
Cc: Sue Goodglick
Subject: Public Opinion Message on SB23

Please support SB 23. Besides believing in quality health care for all beings, it is especially important in the case of tier IV employees within state work. How can these employees feel equal in the work place when receiving inadequate benefits when compared to their fellow cohorts? It creates animosity and ends with disgruntled employees, leaving the state system. From a formal federal employee who "jumped ship" to the state system, though it payed significantly less, it was worth it to me when I compared the benefit package.

Please imagine yourself stuck in tier IV - would you stay a lifetime? I urge you to support SB 23. It's nice to feel your employer cares about your & your family's health.

Regards,
Sue Goodglick
(Tier III)

This is an email message from "Sue Goodglick" <nukasue@yahoo.com>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: wendy nelson [kotze77@hotmail.com]
Sent: Thursday, February 26, 2009 9:27 AM
To: Sen. Joe Paskvan
Cc: wendy nelson
Subject: Public Opinion Message on SB23

Please help us older workers that got into the workplace after 2006 to receive benefits that all the others enjoy. I spent my life working in the private sector and brought my skills to the state only to find that my skills were not to be compensated as much as my coworkers. Please return to compensation that would allow me to assist the state with my skills and customer service skills, attendance and information. I feel that even though i signed on for Tier iv that just compensation could and should include fairness for all. Thanks for voting for us that were not so lucky to have Tier I status...

This is an email message from "wendy nelson" <kotze77@hotmail.com>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: Drew Groth [drewbabe72@gmail.com]
Sent: Thursday, February 26, 2009 9:23 AM
To: Sen. Joe Paskvan
Cc: Drew Groth
Subject: Public Opinion Message on SB23

MESSAGE:

"State employees deserve the security of a guaranteed pension and health insurance in retirement."

"The Tier IV retirement plan does not ensure an adequate and predictable retirement."

"State services suffer when inadequate benefits cause quality employees to seek work elsewhere."

"Please SUPPORT SB 23."

Sincerely,
Drew Groth
907-455-7718

This is an email message from "Drew Groth" <drewbabe72@gmail.com>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: Sara Craig [saracraig4@yahoo.com]
Sent: Thursday, February 26, 2009 9:16 AM
To: Sen. Joe Paskvan
Cc: Sara Craig
Subject: Public Opinion Message on SB23

Senator Joe Paskvan:

I have recently been hired by the Office of Childrens Services with the State of Alaska. To work for the state I love, and give back to the community has always been a long term goal of mine. I have grown up in a family of State and Municipal employees. My mother is a State worker with Alaska Department of Fish and Game, my father is a municipal employee with the Department of Transportation and my sister is a State employee with the Department of Public Safety/State Troopers. My parents have worked very hard and are looking forward to retirement in the near future. Their retirement includes medical for the two of them, and a pension plan that will support them from retirement date on. I look at their retirements, and comparing theirs to mine, I have realized that I will not be able to retire or be excited about retirement like my family members will. With no medical and no pension plan, I will not be able to afford to retire, or even stay working for the state of Alaska. My parents have always taught me to plan for the future, and staying with the State would not be a good choice with the current Defined Contribution Retirement Plan (Tier IV). Thank you for your time, and I strongly erge you to consider switching back to the Defined Benefit retirement system. (Tier III)

Sincerly

Sara Craig
Administrative Clerk II
Office Of Children's Services
323 E. 4th Avenue
Anchorage, AK 99501
Phone (907) 269-1074
Fax (907) 269-3951

This is an email message from "Sara Craig" <saracraig4@yahoo.com>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: Angela Theisen [angela.theisen@alaska.gov]
Sent: Thursday, February 26, 2009 9:13 AM
To: Sen. Joe Paskvan
Cc: Angela Theisen
Subject: Public Opinion Message on SB23

Sen. Joe Paskvan,

Please reinstate the Tier III Defined Benefit retirement system for new state employees. Tier IV individuals require the pension and health insurance to be guaranteed and available to them after the time of service is served for the State of Alaska.

Angela Theisen
DHSS, OCS

This is an email message from "Angela Theisen" <angela.theisen@alaska.gov>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: Rachel Patterson [danarachel88@hotmail.com]
Sent: Thursday, February 26, 2009 8:59 AM
To: Sen. Joe Paskvan
Subject: Public Opinion Message on SB23

Please support SB23.

This is an email message from "Rachel Patterson" <danarachel88@hotmail.com>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: Ashley Cevalco [ash10408@yahoo.com]
Sent: Thursday, February 26, 2009 8:59 AM
To: Sen. Joe Paskvan
Cc: Ashley Cevalco
Subject: Public Opinion Message on SB23

Please support SB23!

This is an email message from "Ashley Cevalco" <ash10408@yahoo.com>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: Heather A. Rhoades [harhoades@gmail.com]
Sent: Thursday, February 26, 2009 8:49 AM
To: Sen. Joe Paskvan
Cc: Heather A. Rhoades
Subject: Public Opinion Message

Please SUPPORT SB 23. State employees deserve the security of a guaranteed pension and health insurance in retirement.

Sincerely,
Heather Rhoades
16239 Waterfall Road
Ketchikan, AK 99901

This is an email message from "Heather A. Rhoades" <harhoades@gmail.com>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: Virginia Kuebelbeck [4talisman@gci.net]
Sent: Thursday, February 26, 2009 8:44 AM
To: Sen. Joe Paskvan
Cc: Virginia Kuebelbeck
Subject: Public Opinion Message on SB23

MESSAGE:
\\\\"State employees deserve the security of a guaranteed pension and health insurance in retirement.\\\\"
\\\\"The Tier IV retirement plan does not ensure an adequate and predictable retirement.\\\\"
\\\\"
\\\\"State services suffer when inadequate benefits cause quality employees to seek work elsewhere.\\\\"
\\\\"Please SUPPORT SB 23.\\\\"

This is an email message from "Virginia Kuebelbeck" <4talisman@gci.net>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: Cecelia Curtis [kolahoi907@hotmail.com]
Sent: Thursday, February 26, 2009 8:38 AM
To: Sen. Joe Paskvan
Cc: Cecelia Curtis
Subject: Public Opinion Message on SB23

State employees deserve the security of a guaranteed pension and health insurance in retirement."

"The Tier IV retirement plan does not ensure an adequate and predictable retirement."

"State services suffer when inadequate benefits cause quality employees to seek work elsewhere."

"Please SUPPORT SB 23."

My own daughter - who has a public administration masters' degree - won't consider working for the state because of the current Tier IV. Cecelia Curtis, State Employee

This is an email message from "Cecelia Curtis" <kolahoi907@hotmail.com>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: Sam Harbo [sjharbo@yahoo.com]
Sent: Thursday, February 26, 2009 8:23 AM
To: Pat Abney; john alacandra; barb angaiak; Jesse Kiehl; Kendra Kloster; barbara rich; Tom Richards; Kristina Ingrid Tornqvist; sam trivette
Cc: willie anderson; Keri Clark; Bob Deitrick; Larry Ehnert; jill exe; Charles Gallagher; lydia garcia; Don Gray; Donald Hadley; Judith A DOR Hall; Don Oberg; siobhan ohara; Tim Parker; Sen. Joe Paskvan; Jerry Patterson; Robb Salo; Susan A Stitham; Sen. Joe Thomas; Judith M Tolbert; Larry Weiss; Kevin T DOA Worley
Subject: Economic Impact of Pension Plans

Hi - A just released publication by the National Institute of Retirement Security is available on the website: www.nirsonline.com. Titled: Pensionomics: Measuring the Economic Impact of State and Local Pensions, it validates the stabilizing effect of DB pensions and the fact that 80% of the funding of these plans comes from investment earnings and employee contributions and only 20% from the taxpayer. In Alaska, because health care is provided to Tier I and II TRS retirees, additional dollars are spent in the community from insurance payments from the state provider and Medicare. This is documented in a publication put out by the state a couple of years ago. Please go to the website to access the document or if you just want state specific data, click on the map for a particular state. For a short time you can hear a digital replay of the teleconference held this morning by calling 1-800-475-6701 and using the access code 988166. I hope you find this information useful. Thanks. Gayle Harbo, NEA-Alaska/Retired

Anna Sorensen

From: Sonja Benson [sonja@mosquionet.com]
Sent: Thursday, February 26, 2009 7:45 AM
To: Sen. Joe Paskvan
Cc: Sen. Joe Thomas; Sen. Bettye Davis; Sen. Kevin Meyer; Sen. Con Bunde
Subject: SB 23 support

Dear Senator Paskvan and Members of the Senate Labor and Commerce Committee, I am writing to voice my support for Senate Bill 23, to repeal the misguided change that was made to state employee retirement benefits to eliminate a defined pension benefit at retirement. As a state employee I am adversely affected by the difficulties in retaining qualified staff and recruiting new staff when the salary, working conditions and benefits are so much more attractive in the private sector and federal government agencies. The new Tier IV system also has eliminated one of the sources of funding for the pensions of Tiers I-III employees by no longer pooling the contributions of the Tier IV employees into the pension fund. So, it did not alleviate the debt burden for the state, but jeopardizes the ability of the state to be a competitive employment option for Alaskans. The State of Alaska needs to look at other resources to fund its obligation to state employee retirement plans. With the incredible wealth this state enjoys, actually handing out \$2 Billion dollars last year in dividends and the fuel assistance checks to all Alaskans (a good chunk of which went straight into federal tax coffers), there is no reason why funds should not be appropriated to fund the obligation of state employee retirement benefits and to restore the defined benefit system for all State of Alaska employees.

Thank you for the opportunity to provide my views on this critical problem.

Sincerely,
Sonja L. Benson
1718 Chena Ridge
P.O. Box 82860
Fairbanks, Alaska 99708
(907) 474-8403

Anna Sorensen

From: Susan Spriggs [forsure@gci.net]
Sent: Thursday, February 26, 2009 7:38 AM
To: Sen. Joe Paskvan
Cc: Susan Spriggs
Subject: Public Opinion Message

State employees deserve the security of a guaranteed pension and health insurance in retirement. Please support SB 23.

This is an email message from "Susan Spriggs" <forsure@gci.net>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: Evelyn R Langley [elangley@alaska.com]
Sent: Thursday, February 26, 2009 4:32 AM
To: Sen. Joe Paskvan
Cc: Evelyn R Langley
Subject: Public Opinion Message on SB23

Dear Senator Paskvan, Chairman:

State employees deserve the security of a guaranteed pension and health insurance in retirement.

The Tier IV retirement plan does not ensure an adequate and predictable retirement.

State services suffer when inadequate benefits cause quality employees to seek work elsewhere.

Please SUPPORT SB 23.

Evelyn R Langley
1241 E 12th Ave #2
Anchorage AK 99501

This is an email message from "Evelyn R Langley" <elangley@alaska.com>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: Barbara Hale [bfhale1@msn.com]
Sent: Wednesday, February 25, 2009 10:33 PM
To: Sen. Joe Paskvan
Cc: Barbara Hale
Subject: Public Opinion Message

Dear Senator Paskvan:

Please support SB 23 to reinstate a defined benefit retirement plan for all state employees.

Not only is the state doing little to support retaining quality career employees through advancement and annual performance evaluations, but also is not encouraging the recruitment of new younger employees to state service which is making it difficult to hire qualified staff. If this continues the brain drain will worsen, and there will be few career employees left who have the understanding of the policies and programmatic requirements to effectively and effeciently administer state programs.

All state employees deserve the security of a guaranteed pension and health insurance in retirement.

The Tier IV retirement plan does not ensure an adequate and predictable retirement.

State services suffer when inadequate benefits cause quality employees to seek work elsewhere.

Thank you.

Sincerely,

Barbara Hale

P.O. Box 240211
Douglas, AK 99824

This is an email message from "Barbara Hale" <bfhale1@msn.com>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: Brian Petrilla [forever_late@msn.com]
Sent: Wednesday, February 25, 2009 8:43 PM
To: Sen. Joe Paskvan
Cc: Brian Petrilla
Subject: Public Opinion Message on SB23

"State employees deserve the security of a guaranteed pension and health insurance in retirement."

"The Tier IV retirement plan does not ensure an adequate and predictable retirement."

"State services suffer when inadequate benefits cause quality employees to seek work elsewhere."

"Please SUPPORT SB 23."

As a state employee for over 9 years I have personally witnessed the applicant pools shrink and positions go unfilled due to lack of interest.

This is an email message from "Brian Petrilla" <forever_late@msn.com>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: jerry farrington [later@gci.net]
Sent: Wednesday, February 25, 2009 8:41 PM
To: Sen. Joe Paskvan
Cc: jerry farrington
Subject: Public Opinion Message on SB23

Tomorrow before the senate is SB 23 that will allow present tier IV employees and future state employees to have a defined benefit retirement plan. As you may be aware the savings for the defined contribution may be minimal at best. But the loss of employees leaving state service once they discover their retirement package has steadily increased. We need to bring those employees back into the state retirement system and recognize that with our reduced wages, they do have a future with state employemnt and some thing to work toward. I urge you to support SB 23 when it comes to a vote and let the hard working state employees know you are with them.

Jerry Farrington

This is an email message from "jerry farrington" <later@gci.net>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: Amy! [amy340@gmail.com]
Sent: Wednesday, February 25, 2009 7:11 PM
To: Sen. Joe Paskvan; Sen. Joe Thomas; Sen. Bettye Davis; Sen. Kevin Meyer; Sen. Con Bunde
Subject: Re: FW: BREAKTIME READING -- ASEA Legislative Alert for SB 23 - Stewards

Good day,

Thank you for taking the time to read my email.

I am vehemently opposed to the Tier IV designation. It does not ensure an adequate and predictable retirement and is a slap in the face to civil servants. Not offering a pension to teachers is a travesty and an embarrassment. State services suffer when inadequate benefits cause quality employees to seek work elsewhere. And who can blame them? State workers have been a convenient whipping boy for years now. As you are no doubt aware, currently Tier I employees are retiring and there are not enough employees "coming up through the ranks" to replace them, especially at Fish and Game. But surely you know this.

Joe Paskvan, I also notice that teachers endorsed you for Senate, according to your webpage.
<http://joepaskvan.com/>

Please SUPPORT SB 23.

Amy Carroll

Anna Sorensen

From: Mary Ann Robinson [robinsonma@mosquitonet.com]
Sent: Wednesday, February 25, 2009 5:36 PM
To: Sen. Joe Paskvan
Cc: Mary Ann Robinson
Subject: Public Opinion Message

"State employees deserve the security of a guaranteed pension and health insurance in retirement."

"The Tier IV retirement plan does not ensure an adequate and predictable retirement."

"State services suffer when inadequate benefits cause quality employees to seek work elsewhere."

"Please SUPPORT SB 23."

This is an email message from "Mary Ann Robinson" <robinsonma@mosquitonet.com>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: Lucy A. Leitz [leitz@gci.net]
Sent: Wednesday, February 25, 2009 4:11 PM
To: Sen. Joe Paskvan
Cc: Lucy A. Leitz
Subject: Public Opinion Message

I have been a State employee since 2002. At that time I came from a company that offered SEP retirement plan. If at that time I had the choice of choosing between the Tier IV plan and what I already had, I would have chosen to stay at my old job.
Please SUPPORT SB 23

This is an email message from "Lucy A. Leitz" <leitz@gci.net>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: Kelly Mansfield [mansfieldkelly@yahoo.com]
Sent: Wednesday, February 25, 2009 4:08 PM
To: Sen. Joe Paskvan
Cc: Kelly Mansfield
Subject: Public Opinion Message

My name is Kelly Mansfield and I live at 1525 Hans Way, Fairbanks. I would appreciate your support in the Senate Bill 23 that would repeal the Defined Contribution Retirement Plan (Tier IV) and replace it with the Defined Benefits Retirement Plan (Tier III). This action would be a start in being competitive to other like positions that would keep valuable people working for the state and also for recruitment. I'm currently employed with the state and feel fortunate to be under the Tier III plan. I do, however, have concerns for my peers who are entering the workforce who are taking jobs elsewhere because the state is not offering what it could for a retirement plan. Please voice support for this bill. Thank you.

This is an email message from "Kelly Mansfield" <mansfieldkelly@yahoo.com>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: Cora Hart [friemering@gmail.com]
Sent: Wednesday, February 25, 2009 3:59 PM
To: Sen. Joe Paskvan
Cc: Cora Hart
Subject: Public Opinion Message

"State employees deserve the security of a guaranteed pension and health insurance in retirement."

"The Tier IV retirement plan does not ensure an adequate and predictable retirement."

"State services suffer when inadequate benefits cause quality employees to seek work elsewhere."

"Please SUPPORT SB 23."

This is an email message from "Cora Hart" <friemering@gmail.com>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: Janice Roberts [janice.roberts@alaska.gov]
Sent: Wednesday, February 25, 2009 3:55 PM
To: Sen. Joe Paskvan
Cc: Janice Roberts
Subject: Public Opinion Message

"State employees deserve the security of a guaranteed pension and health insurance in retirement."

"The Tier IV retirement plan does not ensure an adequate and predictable retirement."

"State services suffer when inadequate benefits cause quality employees to seek work elsewhere."

"Please SUPPORT SB 23."

This is an email message from "Janice Roberts" <janice.roberts@alaska.gov>.
Opinions expressed belong to the sender alone.

Anna Sorensen

From: Leighanne D. Atwood [leiatwood@hotmail.com]
Sent: Wednesday, February 25, 2009 3:53 PM
To: Sen. Joe Paskvan
Cc: Leighanne D. Atwood
Subject: Public Opinion Message on SB23

Good Day,

State employees deserve the security of a guaranteed pension and health insurance in retirement.

The Tier IV retirement plan does not ensure an adequate and predictable retirement.

State services suffer when inadequate benefits cause quality employees to seek work elsewhere.

Please SUPPORT SB 23.

Thank you,

Leighanne D. Atwood

(907) 245-1076

1902 W. 47th Ave, Unit 1

Anchorage, AK 99517

leiatwood@hotmail.com

This is an email message from "Leighanne D. Atwood" <leiatwood@hotmail.com>. Opinions expressed belong to the sender alone.

Anna Sorensen

From: Fleischman, Steve J (DFG) [steve.fleischman@alaska.gov]
Sent: Wednesday, February 25, 2009 9:06 AM
To: Sen. Joe Paskvan
Subject: SB23- please move out of committee

Senator Paskvan,

I urge you to support SB 23, which seeks to repeal the failed Tier IV Defined Contribution Retirement Plan and replace it with a (formerly Tier III) Defined Benefits Retirement Plan that guarantees state employees a pension at retirement. Currently the state of Alaska offers one of the least desirable retirement packages in the nation. Given our lack of eligibility for Social Security, new employee retirement accounts are 100% vulnerable to unstable financial markets.

I have worked for the state since 1989 and was not personally affected by the change to Tier IV in 2006. However I see the backlash everyday in the form of severe recruitment difficulties and flagging employee morale. It is difficult to watch, especially knowing that it is unnecessary.

Please move SB 23 out of committee when you meet on Thursday - it's important.

Steve Fleischman

Anna Sorensen

From: cherian@gci.net
Sent: Wednesday, February 25, 2009 6:49 AM
To: Sen. Joe Paskvan; Sen. Joe Thomas; Sen. Bettye Davis; Sen. Kevin Meyer; Sen. Con Bunde;
Sen. Kim Elton
Subject: SB23 Repeal of Defined Contributions

Honorable Senator Paskvan and Members of the Senate Labor and Commerce Committee:

I would like to encourage you to support of SB 23, which seeks to repeal the Defined Contribution Retirement Plan in place of a Defined Benefits Retirement Plan that guarantees new state employees with a pension at retirement.

I have been working for the state of Alaska over 21 years and has been a supervisor over 19 years. It has been very difficult to attract qualified applicants to fill vacant positions. When the job is not filled with skilled and appropriate professionals, the critical functions of the state government are not handled by competent staff. This will leads to wrong decisions and waste.

I am not personally benefited by the passage of this bill, but I see the benefit of attracting competent professionals to the state workforce. In my view, this will improve performance and ultimately leads to cost savings.

Thank you for your time.

Tom Cherian

Anna Sorensen

From: Friedman_Jeff [Friedman_Jeff@asdk12.org]
Sent: Sunday, February 22, 2009 2:15 PM
To: Sen. Joe Paskvan; Sen. Joe Thomas; Sen. Bettye Davis; Sen. Kevin Meyer; Sen. Con Bunde
Cc: Comeau_Carol; Siegfried_Robin; Steiner_John
Subject: SB 23

Chair Paskvan and Committee Members,

I am writing to urge your support for SB 23 which will be heard by the Labor and Commerce committee on Thursday.

The Anchorage School Board opposed the move to a defined contribution retirement plan several years ago, and has consistently supported a return to a defined benefit plan for both PERS and TRS. The last two years has shown that the anticipated cost savings from moving to the DC plan did not and will not materialize. In fact, the new plan could end up being more expensive.

It seems clear to me that the new plan will make it harder to retain our best employees. Our best employees are the ones most able to look for work in other states. We will provide them with expensive training and after a few years they will be vested and able to

take their training and their retirement dollars to another state that offers a secure pension plan. The District has to then go to the expense of training their replacements. Our teachers do not earn Social Security, so they are in particular need of a defined benefit as part of their retirement and they may look elsewhere for employment as they start a family and start thinking more of the future..

Those of us who live here know that Alaska is a great place to live. People who don't yet live here, however, need to be convinced to give it a try. When recruiting employees out of state, the Anchorage School District needs to be able to show all the reasons why someone should move here. The opportunity to provide a real pension plan to prospective employees would be an important tool in those recruitment efforts.

Please support the return to a defined benefit plan for both PERS and TRS.

Jeff Friedman
Anchorage School Board
1534 D Street
Anchorage, AK 99501
907-742-4699 (Home)

Anna Sorensen

From: lloydfam@gci.net
Sent: Tuesday, February 10, 2009 12:12 PM
To: Sen. Joe Paskvan
Subject: HB 23

This email is to ask you to sponsor HB 23 and return to public employees a secure retirement after years of service to the State of Alaska.

I work for the Anchorage School District as an Occupational Therapist and see how difficult it is to recruit new teachers and therapists to come and work in this wonderful state. I have seen other employers scoop up therapists because the benefits are more desirable and affordable. I am fearful that new teachers and therapists will work the minimum of 5 years and then take their Tier III and IV monies with them; along with all the training they have taken while they are working.

Again, please consider and support public employees.

thank you.

Pamela Lloyd

Anna Sorensen

From: tparker@mosqitonet.com
Sent: Tuesday, February 10, 2009 8:34 AM
To: Sen. Joe Paskvan
Subject: SB 23

Dear Sen. Joe Paskvan,

Thank you so much for attending the Defined Benefit Forum held in early December at Hering Auditorium. It was great to talk to you, and I hope you gathered some helpful information. I see that SB 23 is up for consideration in the Labor and Commerce Committee on Thursday, and of course I'm urging your support. The defined contribution system does not work and is damaging the education system by an increased amount every year. Many moderate Republicans, including Sue Hull were in favor of the switch three years ago, but because of the damage, they have become supporters of a change back to DB. The cost of running the two systems is very close. What should have happened three years ago was a "fix" to the medical benefits associated with TRS. That was the only broken piece of the retirement plan. Of course, the mistakes made by Mercer confounded the problem, but to a certain degree the state bears some responsibility for this because it allowed member groups to lower the amount contributed by the employer during the late 1990s and even into the early 2000s.

SB 23 has three committees attached this year. Your committee is the first hurdle, and I have high hopes that you will look at this bill very closely and put the work into it so that it can move through the system to an eventual passage during this session.

If there is anything I can do to assist, please let me know. Not only am I the vice president of NEA-Alaska, but I'm also an English teacher at Lathrop High School, and one of your biggest fans (both on and off the golf course).

Sincerely,

Tim Parker
Lathrop High School English teacher
Vice president, NEA-Alaska

Anna Sorensen

From: comoxjd@gci.net on behalf of judith anderegg [comoxjd@gci.net]
Sent: Saturday, February 07, 2009 7:26 AM
To: Sen. Joe Paskvan
Subject: SB23 - defined benefits retirement plan

Please support the reinstatement of a defined benefits retirement plan for teachers - as laid out in SB23.

The current defined contributions plan does not provide the kind of retirement that teachers who have spent their entire adult lives educating young people deserve. The lack of a defined benefits retirement plan is detrimental to a stable teaching community. Without a defined benefits retirement plan to be a part of their compensation package, why should teachers (who often do not receive regular or substantial salary increases) commit themselves to a career teaching in Alaska? It also does not provide funding to support the original defined benefits plan and all the teachers who are entitled to receive benefits under its structure.

Further, as we have tried to help our new young friends just entering the teaching profession, we are appalled by the poorly structured and state-managed current "defined

contributions" plan. The plan does not provide for any financial education for the participants nor does it provide adequate "no-load" options for investment. Put simply, the "defined contributions" plan can not possibly provide for an adequate retirement under its current design. Our teachers deserve better.

As teachers with lifetime careers in Alaska who retired under the "defined benefits" plan, we feel that the state recognized our value and contribution to our young people. During our career, we had our salaries frozen several times and never received the kind of salary increases of the private sector, but our retirement plan removed any anxiety over how we would pay for our "golden years." It was a fair trade- we invested ourselves in the youth of the state while the state invested in us.

Further, we have learned from information from Dept. of Administration that the "defined benefits" money has come out way ahead of "defined contributions" money. The professional managed funds have outperformed the individual managed funds. It is clear that the state should return to the "defined benefits" plan for the benefit of all.

Sincerely,
Judith Anderegg and David Pelto

Anna Sorensen

From: Elvira Taylor [ebataylor@yahoo.com]
Sent: Sunday, March 01, 2009 5:54 PM
To: Sen. Joe Paskvan
Subject: SB 23 Repeal of Tier IV Retirement Plan

SB 23 Repeal of Tier IV Retirement Plan

Senator Paskavan,

I urge you to support the repeal of the Tier IV retirement plan for a number of reasons.

1. First, in my opinion, the Tier IV plan was put into law under suspicious circumstances, as were several other laws during that period.
2. State employees deserve the security of a guaranteed pension plan and health insurance at the time of their retirement from State service.
3. The Tier IV retirement plan does not ensure that an elderly State Employee would have an opportunity have a predictable and adequate retirement at the time of leaving State service.
4. State services are beginning to suffer as those of us reach retirement age, and will continue suffer even more in the future if we are unable to hire quality employees willing to learn and retain the knowledge base so that it is transferred on to future generations willing to work for the State. Under the current Tier IV retirement system, I do not feel that will be possible.

The only way the State can continue to guarantee to provide the quality of services at the level it currently provides is to hire quality employees; and to do that the State is going to have to treat its employees adequately and fairly. One way to do that is to provide its employees with guaranteed pension and health insurance at retirement in recognition of its employees services.

I ask that you support reinstatement of the Tier III retirement system for all current and new State employees not already covered by a defined benefit retirement plan, such as the Tier III retirement system.

Respectfully,

Elvira Taylor

Anna Sorensen

From: Buck.George@neaalaska.org
Sent: Monday, March 02, 2009 9:33 AM
To: Sen. Joe Paskvan
Subject: My Apologies

Joe,

Please accept my apology for my e-mails last week. I didn't have the full story of your proposal, and with the short amount of time, acted before I found out the facts.

I believe the change you put forth is a very acceptable one and I will and do support this change. Especially since I know it's one that would have come anyway. Putting this forward now was a good move on your part and hopefully will move our cause along. Thank you, sorry I doubted.

I'd try to leave you a voice mail but it's kind of hard to talk with the crow feathers in my mouth.

Thanks for all you do.....Buck George

P.S. Please pass this along to Jeff.

Anna Sorensen

From: bmrich@gci.net on behalf of barbara rich [bmrich@gci.net]
Sent: Saturday, February 28, 2009 11:20 AM
To: Sen. Kevin Meyer; Sen. Bettye Davis; Sen. Joe Thomas; Sen. Joe Paskvan
Subject: SB23

Dear Senators,

Thank you for passing Senate Bill 23 to the State Affairs Committee. It is a much need plan. Thank you for all your hard work.

Barbara Rich
AKREA President

Anna Sorensen

From: Ellis, Marty E (HSS) [marty.ellis@alaska.gov]

Sent: Friday, February 27, 2009 10:21 AM

To: Sen. Johnny Ellis; Sen. Kim Elton; Sen. Hollis French; Sen. Bill Wielechowski; Sen. Linda Menard; Sen. Joe Paskvan; Sen. Lesil McGuire; Sen. Joe Thomas; Rep. Mark Neuman; Rep. Mike Chenault; Rep. John Coghill; Sen. Bettye Davis; Rep. Bob Lynn; Rep. Bob Buch; Rep. Lindsey Holmes; Sen. Kevin Meyer; Sen. Con Bunde

Subject: SB23 Repeal of Defined Contributions

Senator Paskvan and Members of the Senate Labor and Commerce Committee:

I am asking you to support SB 23, which seeks to repeal the Defined Contribution Retirement Plan in place of a Defined Benefits Retirement Plan that guarantees new state employees with a pension at retirement. The move to a Defined Contribution Retirement Plan in 2006 was an experiment that failed, and it contributes significantly to our difficulties with recruitment and retention of employees. I ask that you right this wrong by supporting SB 23 and moving it out of committee when you meet this afternoon.

Thank you.

Anna Sorensen

From: bmrich@gci.net on behalf of barbara rich [bmrich@gci.net]
Sent: Thursday, February 26, 2009 1:16 PM
To: Sen. Bill Wielechowski; Sen. Tom Wagoner; Sen. Joe Thomas; Sen. Gene Therriault; Sen. Gary Stevens; Sen. Bert Stedman; Sen. Joe Paskvan; Sen. Donny Olson; Sen. Kevin Meyer; Sen. Linda Menard; Sen. Lesil McGuire; Sen. Albert Kookesh; Charlie Huggins; Sen. Lyman Hoffman; Sen. Hollis French; Sen. Kim Elton; Sen. Johnny Ellis; Sen. Fred Dyson; Sen. Bettye Davis; Sen. Con Bunde
Subject: [SPAM]
Attachments: factsheet_AK retirement issues.pdf

This is for your information

Barbara Rich
AKREA President

Anna Sorensen

From: Brooks, Kevin A (DOA) [kevin.brooks@alaska.gov]
Sent: Thursday, February 26, 2009 1:03 PM
To: Jesse Kiehl; Jeff Stepp; Sen. Joe Paskvan
Cc: Kreitzer, Annette E (DOA); Rowland, Mindy B (GOV); Shier, Patrick J (DOA)
Subject: Follow-up on SB23 Questions

Sen. Paskvan et al.:

I have just spent the last hour on the telephone with our actuary at Buck Consultants and have answers to the questions raised in our meeting this morning.

- 1) Does the fiscal note analysis reflect a % or number of DCR members coming into the DB plan that will not ultimately vest in health benefits?

Yes, the actuarial model contemplates that not all members will vest in health benefits.

- 2) Does the fiscal note analysis reflect that current DCR members would have accrued a health benefit under the current system, and adjust the DB health projection accordingly?

Yes, the actuarial model transfers all assets and accrued liabilities related to health benefits in the DCR plan to the DB plan, and calculates the new anticipated cost of DB health benefits only. There is no "double-counting" of benefits.

- 3) What is the disposition of Health Reimbursement Account (HRA) assets in the fiscal note analysis?

HRA assets are transferred into the DB plan with other DCR assets and offset the unfunded liability related to health benefits.

- 4) In Buck's February 12, 2009 letter to Pat Shier (RE: Alaska PERS and TRS Comparison of DB versus DCR Ongoing Costs), the TRS Tier 2 rate of 8.96% is lower than the TRS Tier 3 rate of 11.44%. The table in the fiscal note shows a TRS normal cost increase of 1.45% as a result of the bill. How does the rate go from 2.44% lower to 1.45% higher?

The two analyses address related but different questions. The rates in the February 12 letter were determined using the payroll applicable to each group and are not based on total payroll. We have asked Buck to prepare an analysis that walks through the rate development methodology and shows how the rates are related. We expect that analysis by early next week (March 2 or 3). Buck has confirmed that the fiscal note analysis is correct.

Based on this information, we are confident that the fiscal note submitted to the committee this morning accurately reflects the cost of the bill.

Please let me know if you have any questions or require additional information.

Sincerely,

Kevin Brooks
Deputy Commissioner
Department of Administration

Anna Sorensen

From: Carroll, Holly C (DFG) [holly.carroll@alaska.gov]
Sent: Thursday, February 26, 2009 11:34 AM
To: Sen. Joe Paskvan
Cc: Sen. Bettye Davis; Sen. Kevin Meyer; Sen. Joe Thomas; Sen. Hollis French; Sen. Bill Wielechowski; Sen. Linda Menard; Sen. Lesil McGuire; Sen. Johnny Ellis; Sen. Kim Elton
Subject: in support of SB 23

Dear Senators,

I want to first thank you for your State service. As a fellow government employee, I understand the rewards and challenges of working for the State, and know that there probably isn't a single one of us that does it because the pay is better than other jobs. We do it because it's important, meaningful work that many of us would continue to perform without increase in incentives. But when the incentives and benefits that we DO have are stripped away, it is demoralizing, and hurts our opportunity to recruit new employees, and compete with other industries and employers.

With so much of our current workforce imminently retiring, the State will be relying heavily on retaining newly tenured employees, and recruiting new bright individuals to government positions. But recent graduates have many choices ahead of them, and changing the Defined Benefits Retirement Plan was a mistake that will lead many *potential* state employees elsewhere. As a hiring manager, I have recruited over 20 positions from the technician level through the professional Fishery Biologist level. In the last few years, despite increased recruitment efforts through career fairs and advertising, I have seen a drop in interest in state positions, and have even lost potential employees *after* offering positions, because they've had better offers from other employers. Changing the "good retirement" benefits that the state used to be known for, has not helped us to recruit and retain employees- it has made it worse!

I therefore support SB 23, which seeks to repeal the Defined Contribution Retirement Plan in place of a Defined Benefits Retirement Plan that guarantees new state employees with a pension at retirement. I hope that you will too.

Thank you sincerely for your time and consideration for this important matter,

Holly Carroll

Fishery Biologist, Pilot Station Sonar Project
ADF&G, Commercial Fisheries
1300 College Rd, Fairbanks, AK 99701

phone: (907) 459-7384
fax: (907) 459-7271

Anna Sorensen

From: Don Oberg [doberg907@hotmail.com]
Sent: Thursday, February 26, 2009 10:38 AM
To: sjharbo@yahoo.com; abney1@acsalaska.net; john.alcantra@neaalaska.org; barbangaiak@hotmail.com; Jesse Kiehl; Kendra Kloster; bmrch@gci.net; richards.alaska@gmail.com; kristina Tournquist; samtriv@gci.net
Cc: willie.anderson@neaalaska.org; kerri.clark@neaalaska.org; deitrick@ptialaska.net; lehnert@northstar.k12.ak.us; jill.exe@nsbsd.org; cgallagher@alaska.net; lydia.garcia@neaalaska.org; dcgray@mosquitonet.com; Donald Hadley; judy.hall2@alaska.gov; ohara_siobhan@yahoo.com; Tim; Sen. Joe Paskvan; jpcp@gci.net; salo@gci.net; sstitham@northstar.k12.ak.us; Sen. Joe Thomas; jtolbert@northstar.k12.ak.us; ldweiss@acpp.info; kevin.worley@alaska.gov
Subject: RE: Economic Impact of Pension Plans

great info - thanks, Don

> Date: Thu, 26 Feb 2009 09:22:38 -0800
 > From: sjharbo@yahoo.com
 > Subject: Economic Impact of Pension Plans
 > To: abney1@acsalaska.net; john.alcantra@neaalaska.org; barbangaiak@hotmail.com; Jesse_Kiehl@legis.state.ak.us; kendra.kloster@legis.state.ak.us; bmrch@gci.net; richards.alaska@gmail.com; nskit@uaf.edu; samtriv@gci.net
 > CC: willie.anderson@neaalaska.org; kerri.clark@neaalaska.org; deitrick@ptialaska.net; lehnert@northstar.k12.ak.us; jill.exe@nsbsd.org; cgallagher@alaska.net; lydia.garcia@neaalaska.org; dcgray@mosquitonet.com; hadley_donald@msn.com; judy.hall2@alaska.gov; doberg907@hotmail.com; ohara_siobhan@yahoo.com; tparker@mosquitonet.com; Senator_Joe_Paskvan@legis.state.ak.us; jpcp@gci.net; salo@gci.net; sstitham@northstar.k12.ak.us; Senator_Joe_Thomas@legis.state.ak.us; jtolbert@northstar.k12.ak.us; ldweiss@acpp.info; kevin.worley@alaska.gov
 >
 >
 > Hi - A just released publication by the National Institute of Retirement Security is available on the website: www.nirsonline.com. Titled: Pensionomics: Measuring the Economic Impact of State and Local Pensions, it validates the stabilizing effect of DB pensions and the fact that 80% of the funding of these plans comes from investment earnings and employee contributions and only 20% from the taxpayer. In Alaska, because health care is provided to Tier I and II TRS retirees, additional dollars are spent in the community from insurance payments from the state provider and Medicare. This is documented in a publication put out by the state a couple of years ago. Please go to the website to access the document or if you just want state specific data, click on the map for a particular state. For a short time you can hear a digital replay of the teleconference held this morning by calling 1-800-475-6701 and using the access code 988166. I hope you find this
 > information useful. Thanks. Gayle Harbo, NEA-Alaska/Retired
 >
 >
 >

Windows Live™ Hotmail@...more than just e-mail. [See how it works.](#)

Anna Sorensen

From: Lim, Won T (DFG) [won.lim@alaska.gov]

Sent: Thursday, February 26, 2009 10:34 AM

To: Sen. Joe Paskvan

Subject: Repeal Defined Contributions Retirement Plans (Tier IV) - Senate Hearing Thursday

I have been working for Department of Fish and Game since March 2006. Because I wasn't working full-time (I'm full-time now) back then, I was reverted to Tier IV plan. For personnel's like us, this Senate Bill is highly attractive incentive package that will help not only on recruiting new hires but give the faithful peace of mind. Thank you for your consideration and have a nice day.

Anna Sorensen

From: Kuebelbeck, Virginia M (DOT) [virginia.kuebelbeck@alaska.gov]
Sent: Thursday, February 26, 2009 8:30 AM
To: Sen. Joe Paskvan
Subject: Please vote yes to Repeal of the Tier IV Retirement Plan (SB 23)

Dear Senator Paskvan,

Please vote yes to Repeal of the Tier IV Retirement Plan (SB 23)

MESSAGE:

"State employees deserve the security of a guaranteed pension and health insurance in retirement."

"The Tier IV retirement plan does not ensure an adequate and predictable retirement."

"State services suffer when inadequate benefits cause quality employees to seek work elsewhere."

"Please SUPPORT SB 23."

Sincerely
Virginia Kuebelbeck Local 52 member
4talisman@gci.net

3/13/2009

Anna Sorensen

From: Robert Powers [rpowers@attalacom.net]

Sent: Wednesday, February 25, 2009 11:25 PM

To: Sen. Joe Paskvan

Subject: Please vote in favor of SB 23

Dear Senator Paskvan;

When SB 141 was passed it removed any **retirement security** public employees, teachers, police officers and firefighters in Alaska enjoyed. Please remember private sector employees pay into Social Security, which offers a defined benefit that will be there for life offering them a source of retirement security. Under the current system (PERS Tier IV and TRS Tier III) employees pay into a defined contribution plan, which may not provide the necessary income for retirement.

Please support the employees that make public service a career, by offering them a secure retirement.

Please vote in favor of SB 23.

Thanks
Bob Powers

Anna Sorensen

From: kkam@alaska.com on behalf of Kurt Kamletz [kkam@alaska.com]
Sent: Wednesday, February 25, 2009 8:32 PM
To: Sen. Bill Wielechowski
Cc: Sen. Con Bunde; Sen. Kevin Meyer; Sen. Bettye Davis; Sen. Joe Thomas; Sen. Joe Paskvan
Subject: SB23 Repeal of Defined Contributions

Senator Wielechowski and Members of the Senate Labor and Commerce Committee:

I would like to take this opportunity to thank you for your consideration and support of SB 23. The repeal the Defined Contribution Retirement Plan in place of a Defined Benefits Retirement Plan guarantees new state employees with a pension at retirement.

The Defined Contribution Retirement Plan in 2006 was a monumental failure. This is perhaps the largest single contributor to our difficulty recruiting and retaining employees. I ask that you right this wrong by supporting SB 23 and bring it to the floor as soon as possible.

Thanks again,
Kurt Kamletz
905 Muldoon Rd; A29
Anchorage, AK 99504
(907) 332-3457

Anna Sorensen

From: drobbins@gci.net on behalf of Doris Robbins [drobbins@gci.net]
Sent: Wednesday, February 25, 2009 8:02 PM
To: Sen. Joe Paskvan; Sen. Joe Thomas
Cc: Sen. Con Bunde; Sen. Bettye Davis; Sen. Kevin Meyer
Subject: Attached message from April 2005 opposing SB 141 and the end of PERS/TRS
Importance: High
Attachments: Doris Robbins.vcf; Testimony Against SB 141 of April 2005.doc

Senator Paskvan,
Senator Thomas,
Senate Labor & Com. Cmte.

I could rehash everything I said when I originally testified with point by point facts but I'm just worn out with it! Anyone who really looks at facts without some ulterior motive can see that to have a viable state workforce the Defined Benefit System that we originally had when applied correctly is the best choice for Alaska. Tier III had fixed the problems of the Tier I system. We Tier I are dying out faster that could have been hoped for by some who were behind SB 141.

Problems with unfunded mandates did not come from employees. Lack of understanding, powerful people and political interests, I'm guessing, were behind granting full retirement to some who worked few hours and did not pay their full share because legislators unaware of future consequences gave it to them. Among additional reasons, early retirement programs did not account for cost. A faulty actuary was allowed to run the state into the red while saying everything was fine. I have to wonder if this was not pre-meditated by an administration that wanted to set public employees up for a fall.

When SB141 was proposed these faults were ignored and "those greedy union hires" were given all the blame. Studies and historical examples from other states who tried Defined Contribution and went back to Defined Benefit as the better choice after all were available at the time. As a member of the Retired Public Employees of Alaska, I did everything I could to make sure it was known.

I just dug up an electronic letter that I wrote toward the end of the original hearings when the PERS/TRS was being dismantled and have attached it. I inserted an addendum to show my current address and for clarification.

You must have thousands of hours of testimony from state employees all over the state that you should take a look at in retrospect now that what we said is coming true. No one has changed their opinion! The state is now raising up some potential retirees who will, out of necessity, be on Medicaid within 5 years of retirement for lack of ability to access health care. The state will find that enlightened workers will not work for long under the current Defined Contribution arrangement.

In addition, I will be emailing a document prepared by a former state auditor that I retained in my electronic files. It demonstrates how the 105% stipulation changes the retirement benefit for the already vested employees that had been told the new legislation would not hurt their retirement.

I ask that you please pass SB 23 and return Alaska's retirement system to a real functioning retirement system.

Sincerely,

Doris Robbins
drobbins@gci.net
1281 Overhill Dr.
Fairbanks AK 99709
(907) 374-0597

Anna Sorensen

From: drobbins@gci.net on behalf of Doris Robbins [drobbins@gci.net]
Sent: Wednesday, February 25, 2009 8:02 PM
To: Sen. Joe Paskvan; Sen. Joe Thomas
Cc: Sen. Con Bunde; Sen. Bettye Davis; Sen. Kevin Meyer
Subject: SB 141 and the Post Retirement Pension Adjustment
Importance: High

Senator Paskvan,
 Senator Thomas,
 Senate Labor & Com Members,

The following is a document prepared by Charlie Gallagher, a former state auditor who worked for DOL in Employment Security. He happens to currently head the local Retired Public Employees of Alaska (RPEA) chapter in Fairbanks. I think his information is self explanatory if you read it through. It puts to lie the mantra that the new Defined Contribution system would do nothing to affect those in the old Defined Benefit system.

For questions on his calculations you may reach Charlie at this email address: Charlie Gallagher <cgallagher@alaska.net>.

Sincerely,

Doris Robbins
 drobbins@gci.net
 1281 Overhill Dr.
 Fairbanks AK 99709
 (907) 374-0597

To:
Sent: Saturday, March 11, 2006 6:01 AM
Subject: #1 PRPA 3/10/06

This message from Charlie Gallagher is being sent to you as a part of the email network - designed to keep us informed on important issues. It is being sent blind carbon copy to avoid distributing email addresses. Should you wish to be taken off the list, please let me know. If you wish to remain on our email network list, please keep us informed of any changes in your email address.

Post Retirement Pension Adjustment

1.

The Issue-

The SB141 Problem has led to many new members. Several want to know if their pensions will be inflation proofed after they are 60 or retired 5 years. The confusion is with the language in an amendment which precluded the administrator from acting upon inflation proofing if the retirement funds were not at 105% funding. The second confusion was the misinformation regarding whether this applied to current plan members.

This is a record of the dialogue from after our meeting with Senator Wilken on Feb. 22, 2006, his response, and our follow up fact finding with Retirement and Benefits.

Sen. Seekins would not see us despite the fact we had an appointment. Representative Guttenberg and Representative Holm were also visited. Rep. Ramras was not found and Representative Kelly said he was unavailable.

The Law-

Sec. 18. AS 14.25.143(a), as that subsection read following amendment by sec. 3, ch. 146, SLA 1980, until amended by sec. 12, ch. 106, SLA 1988, is amended to read:

(a) When the administrator determines that the cost of living has increased and that the financial condition of the retirement fund permits, the administrator shall increase benefit payments to persons receiving benefits under this plan. **For purposes of this subsection, the financial condition of the fund would only permit an increase in benefits when the ratio of total fund assets to the accrued liability meets or exceeds 105 percent. In this subsection, "accrued liability" means the present value of all member benefits accrued by member service in this plan [SYSTEM].**

Fact Finding-

1. Information supplied to our member by R+B on 1-4-06:

To R+B: Thank you very much for your speedy reply. I'm familiar with the site you suggested; my interest is in how PRPA and other retirement benefits will be affected when SB141 goes into effect on July 1 of this year. Thanks again, our member--

R+B Reply: SB 141 will not effect you at all. This bill affects only newly hired members joining the system after July 1, 2006.

2. Our Visit to Senator Wilken at 1PM, 2-22-06. Doris Robbins, Judith, and myself-

To Sen. Wilken: "you said at our 12-17 - meeting that our retiree benefits were not changing, but then you informed us the fund had to be 105% funded to be inflation proofed." that was why so many people were upset with him about the situation.

Senator Wilken replied: "This is not true". Your benefits are "bulletproof". He heard this at the Finance Committee table that 'retiree benefits were inflation proofed. He would look into it with Senator Stedman and Retirement and Benefits.

So this is the answer- from Sen. Wilken according to Sen. Stedman.

2.

Senator Wilken's reply by E-Mail on 2-24-06—

Hello Mr. Gallagher and Mrs. Robbins:

I checked with Senator Stedman. Your pension payments under Tier 1,2, and 3, are adjusted (after age 59 or 5 (PERS) / 8 (TRS) years of retirement) for inflation through either an "ad hoc" (Tier 1 only) or an "automatic" method of adjustment.

The method is **a function of the funding level**, but one way or the other, the protection exists.

For clarification or verification, please call Dept. of Retirement Benefits, Ms. Kathy Lea (465-3226).

Hope this helps a bit. Thanks for spending your time with me.

Keep an eye on the ARM Board.

Gary Wilken

Phone Call to Ms. Kathy Lea at Retirement and Benefits on 3-1-06---

This is a copy of the E-mail I sent to Doris Robbins

Doris: Per Sen. Wilken I called Kathy Lea at R+ B. 465 3226. I asked her for clarification:

1. Automatic inflation proofing still continues as before at 50% of the Anchorage cpi for all three tiers until 65 and 75% after 65.
2. There is an Ad Hoc provision for tier 1 to get 100% of the Anchorage cpi, if the Commissioner requests it. **However SB141 now defines that the fund must be 105% in order for the Commissioner to even consider the 100% "Ad Hoc" inflation proofing. Therefore there is no way in the current situation for tier 1 to get 100% inflation proofing. Due to SB141 and the Legislature's refusal to fund the alleged shortfall the Republican majority precluded the opportunity for 100% inflation proofing.**

The Handbook— Every tier-one retiree was promised their retirement would be inflation proofed. It was set in law. Other pensions such as Social Security are inflation proofed. There is a reliance on Government to keep its promises.

Discussion of the Consequences---

Diminishment- Sen. Gary Wilken's statement that there was no "diminishment" is his belief. It is quite apparent from his strong statements to us at the Noel Wien library in December and in person on February 22nd he was **told** there was no diminishment. His recent E-mail refines his assumption to include "while this is a function of the funding level" points out an epiphany of understatement. **There is a strong supposition that Sen. Wilken and many others did not understand the effect of the 105% amendment buried in this bill.**

For Tier 1, clearly there is clearly a diminishment. While it depended upon the request of a Commissioner, after SB 141 is in effect the Commissioner cannot even elect the Ad hoc prpa unless the fund is determined to be 105% funded.

3.

Example- **If one is receiving a \$20,000.00/ year PERS or TRS retirement**, one will at least get inflation proofing at 50% at 60 and 75% at 65. Without the Ad hoc 100% and **assuming one is 60, at a 3.5%* inflation rate over 30 years your \$20,000.00 will be worth about 65% or \$13,000.00/ year in current buying power.**

With the Ad Hoc it could be worth \$20,000.00 as long as a Commissioner chose to exercise the prpa provision consistently. SB141 passage definitely diminishes Tier 1.

I don't think Sen. Wilken understood this until we brought it to his attention. Ms. Lea stated this is something she explains frequently to retirees.

* This is assumed slightly high, but pragmatic given the current U.S. debt structure due to war and the current application of Keynesian economic tax structure.

Flaw in reasoning- Sen. Stedman's reasoning places the burden upon the most senior retirees. Society does not expect persons in their high seventies and eighties to return to work to replace what they were promised. The law informed them they were to be inflation proofed. The insertion of 105% circumstances is most cynical in its very nature. By the nature of the amendment it places the burden of the current under fund of the PERS/TRS Trust upon innocent and vulnerable people.

The real fault lies with the past Alaska Administration and the Alaska Legislature for continuing misinterpretation of the actuarial determinations and lobbying for lower municipal rates according to consistent testimony and media.

Finally, according to Senator Wilken there is no intention to fund the shortfalls in 2006.

Request and Resolution— Restore the former status of AS 14.25.143 (a) in HB 475.

Charlie Gallagher

Anna Sorensen

From: Toni [tonic314@yahoo.com]
Sent: Wednesday, February 25, 2009 5:56 PM
To: Sen. Hollis French
Cc: Sen. Joe Paskvan; Sen. Joe Thomas; Sen. Bettye Davis; Sen. Kevin Meyer; Sen. Con Bunde
Subject: SB23 Repeal of defined Contributions

Senator Paskvan and Members of the Senate Labor and Commerce Committee:

I would like to take the opportunity to provide support of SB 23, which seeks to repeal the Defined Contribution Retirement Plan in place of a Defined Benefits Retirement Plan that guarantees new state employees with a pension at retirement. The move to a Defined Contribution Retirement Plan in 2006 was an experiment that failed, and it contributes significantly to our difficulties with recruitment and retention of employees. I ask that you right this wrong by supporting SB 23 and moving it out of committee when you meet on Thursday, 26 February.

Thanks,
Toni Hackney
Tier II

Anna Sorensen

From: Buck.George@neaalaska.org
Sent: Wednesday, February 25, 2009 4:52 PM
To: Sen. Joe Paskvan
Subject: SB 23

Joe and Jeff,

I would like to talk with you but am tied up in meetings in Anchorage. I tried calling and left a voice message, but I'm afraid we'll be playing phone tag.

Joe, what I am hearing about your proposal is that it basically is a tier 4 TERS and tier 5 PERS. If this is the case then this is not acceptable. I believe that a **return** is what we have been advocating. Anything less is not something I would care to see or would encourage you to pursue, as it is not a return but going someplace else.

Please pass SB 23 out of committee in the form it has been introduced. Again we have many sponsors who support it, and I feel it too early in the process to begin diluting what we have a real shot a getting.

Buck George

Anna Sorensen

From: Cheng, Wei (DFG) [wei.cheng@alaska.gov]
Sent: Wednesday, February 25, 2009 4:18 PM
To: Sen. Joe Paskvan; Sen. Joe Thomas; Sen. Bettye Davis; Sen. Kevin Meyer; Sen. Con Bunde
Subject: SB23 Repeal of Defined Contributions

Senator Paskvan and Members of the Senate Labor and Commerce Committee:

Thank you for the opportunity last week to provide testimony in support of SB 23, which seeks to repeal the Defined Contribution Retirement Plan in place of a Defined Benefits Retirement Plan that guarantees new state employees with a pension at retirement. The move to a Defined Contribution Retirement Plan in 2006 was an experiment that failed, and it contributes significantly to our difficulties with recruitment and retention of employees. I ask that you right this wrong by supporting SB 23 and moving it out of committee when you meet on Thursday, 26 February.

Thank you.

Wei Cheng
Fisheries Geneticist I
Alaska Department of Fish and Game
Commercial Fisheries Division
333 Raspberry Road
Anchorage, AK 99518
Phone:907-267-2167
Email:wei.cheng@alaska.gov

Anna Sorensen

From: Melanie Arnolds [melanie.arnolds@gmail.com]

Sent: Wednesday, February 25, 2009 4:15 PM

To: Sen. Joe Paskvan

Subject: SB 23

Dear Senator Paskvan,

I am writing you to voice my support for SB 23 which will repeal the DC plan and reinstate a pension and health insurance system for new State employees that will ensure an adequate and predictable retirement.

I am a state employee and really enjoy my work as well as my work environment. I am a registered professional engineer who could probably make a lot more money in the private sector. However, since I am a Tier III; the benefit package is keeping me loyal and dedicated to state.

We have a difficult time hiring new engineers and other staff members since the State has a very unattractive salary package. The low salary plus a non guarantee on pension definitely hurts every State Department when desperately trying to hire qualified and hard working individuals to become part of their team.

I strongly urge you to support the re-enactment of Tier III benefits and slash the current Tier IV benefit package.

Thank you for your hard work and efforts in this matter,

-Melanie Arnolds

Anna Sorensen

From: Kjera, Dolores A (DFG) [dolly.kjera@alaska.gov]
Sent: Wednesday, February 25, 2009 4:13 PM
To: Sen. Joe Paskvan; Sen. Joe Thomas; Sen. Bettye Davis; Sen. Kevin Meyer; Sen. Con Bunde
Subject: sb23 repeal of defined contributions

Senator Paskvan and Members of the Senate Labor and Commerce Committee:

Thank you for the opportunity last week to provide testimony in support of SB 23, which seeks to repeal the defined contribution Retirement Plan in place of a Defined Benefits Retirement Plan that guarantees new state employees a pension at retirement. The move to a defined contribution retirement plan in 2006 was a experiment that failed. And it contributes significantly to our difficulties with recruitment and retention of employees. I ask that you right this wrong by supporting SB 23 and moving it out of committee when you meet on Thursday, February 26.

Thanks,

Dolly Kjera
2658 Old Steese Hwy N
Fairbanks, AK 99712

Anna Sorensen

From: Buck.George@neaalaska.org
Sent: Wednesday, February 25, 2009 3:08 PM
To: Sen. Joe Paskvan
Subject: RE: SB 23

Jeff,

Thanks for the quick response. I am tied up in trainings in Anchorage but will try to call as soon as I get a chance.....Buck George

From: Sen. Joe Paskvan [mailto:Senator_Joe_Paskvan@legis.state.ak.us]
Sent: Wednesday, February 25, 2009 2:00 PM
To: George, Buck [AK]
Subject: RE: SB 23

Hi Buck,

I left you a voice mail just a few minutes ago, and understand that you are out of the office for the rest of the week.

Please call me at your earliest convenience so that we can discuss SB 23.

Joe is trying to win the war for restoring the defined benefit retirement plan, not just this one battle in his own committee. He has been working closely with the bill sponsor and other legislators, and I assure you that he is on your side.

Best,
Jeff

Direct Line: (907) 465-4747

Jeff Stepp
Office of Senator Joe Paskvan
Alaska State Capitol, Room #7
Juneau, Alaska 99801

email: jeff.stepp@legis.state.ak.us
phone: (907) 465-3709
fax: (907) 465-4714

From: Buck.George@neaalaska.org [mailto:Buck.George@neaalaska.org]
Sent: Wednesday, February 25, 2009 8:47 AM
To: Sen. Joe Paskvan
Subject: SB 23

Dear Joe,

SB 23 has now been heard twice in Labor and Commerce but has not yet been passed out of committee. I have been informed that it is your intent to introduce an amended or somehow altered form of this Bill.

Joe, we have 9 of 20 Senators and 17 of 40 Representatives sponsoring this Bill in either the SB or HB form. It is

3/13/2009

way too early in the process to begin introducing changes.

Your friends in Fairbanks supported your commitment to return to Defined Benefit Retirement System. To hear now that you are intending to propose a Hybrid is very disconcerting.

Please pass SB 23 out of committee in its original, and unchanged, form.

Sincerely,

Buck George

Anna Sorensen

From: Kohl, Brehan K (DEC) [brehan.kohl@alaska.gov]
Sent: Wednesday, February 25, 2009 3:06 PM
To: Sen. Con Bunde; Sen. Joe Paskvan; Sen. Joe Thomas; Sen. Kevin Meyer; Sen. Con Bunde; Sen. Kim Elton; Sen. Johnny Ellis; Sen. Hollis French; Sen. Bill Wielechowski; Sen. Linda Menard; Sen. Joe Paskvan; Sen. Lesil McGuire; Sen. Joe Thomas; Sen. Kevin Meyer; Rep. Charisse Millett
Subject: SB23 Repeal of Defined Contributions

Senator Meyer and Members of the Senate Labor and Commerce Committee:

Thank you for the opportunity last week to provide testimony in support of SB 23, which seeks to repeal the Defined Contribution Retirement Plan in place of a Defined Benefits Retirement Plan that guarantees new state employees with a pension at retirement. The move to a Defined Contribution Retirement Plan in 2006 was an experiment that failed, and it contributes significantly to our difficulties with recruitment and retention of employees. I ask that you right this wrong by supporting SB 23 and moving it out of committee when you meet on Thursday, 26 February.

Brehan Kohl, REHS, MPH
Environmental Health Officer
555 Cordova, 5th Floor
Anchorage, AK 99501
Phone: 907.269.7636
Fax: 907.269.7510

Anna Sorensen

From: seanutt@gci.net on behalf of Cecil & Lynnette [seanutt@gci.net]
Sent: Wednesday, February 25, 2009 1:53 PM
To: Sen. Kim Elton; Sen. Joe Paskvan; Sen. Joe Thomas; Sen. Bettye Davis;
Senator_Kevin_Myer@legis.state.ak.us; Sen. Con Bunde
Subject: SB23 Repeal of Defined Contributions

Senator Elton and Members of the Senate Labor and Commerce Committee:

My name is Lynnette McNutt and I am a state employee working for the Dept. of Fish and Game. As a Tier IV employee, I am in full support of repealing Tier IV and replacing it with something more equitable such as the Tier III program. I am painfully aware of Tier IV's deficits. I held a student intern position with the state during the Tier I days and upon my recent hire back with the State, I have learned my past internship employment does not qualify me as a Tier I candidate. As I see it, recruitment and then retention of a state worker is challenging due to the substandard state pay scale in comparison to the Federal government and Private sector. A better retirement plan is one way for the state to compete for quality workers and their longevity. Many of our programs are starting to suffer due to the loss of the institutional knowledge the Tier I retirees are starting to take with them. I have seen it in my department already. I am not convinced yet to make a career commitment with the state due to finances, but would certainly be more enticed if the retirement plan was improved. I am curious why the perceived financial savings of the Tier IV retirement plan did not equate into higher state wages as planned.

Thank you for taking the time to read my opinion.

Sincerely,
Lynnette McNutt

19929 Cohen Drive
Juneau, AK 99801

Anna Sorensen

From: Zhang, Xinxian (DFG) [xinxian.zhang@alaska.gov]
Sent: Wednesday, February 25, 2009 1:41 PM
To: Sen. Joe Paskvan; Sen. Joe Thomas; Sen. Bettye Davis; Sen. Kevin Meyer; Sen. Kevin Meyer;
Sen. Con Bunde
Subject: SB23 Repeal of Defined Contributions

Senator Paskvan and Members of the Senate Labor
and Commerce Committee:

Thank you for the opportunity last week to provide testimony in support of SB 23, which seeks to repeal the Defined Contribution Retirement Plan in place of a Defined Benefits Retirement Plan that guarantees new state employees with a pension at retirement. The move to a Defined Contribution Retirement Plan in 2006 was an experiment that failed, and it contributes significantly to our difficulties with recruitment and retention of employees. I ask that you right this wrong by supporting SB 23 and moving it out of committee when you meet on Thursday, 26 February.

Xinxian Zhang, Biometrician III
Alaska Department of Fish and Game
Commercial Fisheries Division
333 Raspberry Road
Anchorage, AK 99518-1565
Work 907-267-2123

Anna Sorensen

From: Amundson, Pamela J (DFG) [pam.amundson@alaska.gov]
Sent: Wednesday, February 25, 2009 12:07 PM
To: Sen. Joe Paskvan; Sen. Joe Thomas; Sen. Bettye Davis; Sen. Kevin Meyer; Sen. Con Bunde
Subject: SB23 Repeal of Defined Contributions

Senator Paskvan and Members of the Senate Labor and Commerce Committee:

Thank you for the opportunity last week to provide testimony in support of SB 23, which seeks to repeal the Defined Contribution Retirement Plan in place of a Defined Benefits Retirement Plan that guarantees new state employees with a pension at retirement. The move to a Defined Contribution Retirement Plan in 2006 was an experiment that failed, and it contributes significantly to our difficulties with recruitment and retention of employees. I ask that you right this wrong by supporting SB 23 and moving it out of committee when you meet on Thursday, 26 February.

Thank you,
Pam Amundson

3/13/2009

Anna Sorensen

From: Kimberly Klein [kimjklein@gmail.com]
Sent: Wednesday, February 25, 2009 1:01 PM
To: Sen. Joe Paskvan; Sen. Joe Thomas; Sen. Bettye Davis; Sen. Kevin Meyer; Sen. Con Bunde; Sen. Kim Elton; Sen. Johnny Ellis; Sen. Hollis French; Sen. Bill Wielechowski; Sen. Linda Menard; Sen. Lesil McGuire
Subject: SB23 Repeal of Defined Contributions

Dear Senator Hollis and Members of the Senate Labor and Commerce Committee:

Please pass SB 23, which seeks to repeal the Defined Contribution Retirement Plan for State employees and replace it with a Defined Benefits Retirement Plan that guarantees new state employees with a pension at retirement.

The move to a Defined Contribution Retirement Plan in 2006 was an experiment that failed, and it contributes significantly to our difficulties with recruitment and retention of employees. I ask that you right this wrong by supporting SB 23 and moving it out of committee when you meet on Thursday, 26 February.

As a voting citizen in District 25-M and a Tier IV State employee with only a contribution-based retirement plan, I am very interested in knowing that you support this bill.

In today's economy. The defined contribution plan offers no assurance of long-term security. I am in a career field (Biology), where professionals are chronically undervalued and underpaid. As such, I am always looking for the best options in terms of pay and benefits. A pension-type retirement plan would go a long way toward motivating me to suspend by on-going job hunt and continue to work for the State of Alaska.

The State should consider this an opportunity to invest in it's own long-term best interest. If this bill is not passed, people like me will continue to look at State positions as training grounds from which to learn from and then move on to higher paying private and federal jobs with better benefits.

To sponsors of this bill: Thank you for investing your time and effort in the future of the State. Your work is appreciated!

Sincerely, Kimberly Klein

--
Kimberly Klein

Anna Sorensen

From: Spiers, James K (DEC) [james.spiers@alaska.gov]

Sent: Wednesday, February 25, 2009 12:07 PM

To: Sen. Kim Elton; Sen. Joe Paskvan; Sen. Joe Thomas; Sen. Bettye Davis; Sen. Kevin Meyer; Sen. Con Bunde; Sen. Johnny Ellis; Sen. Hollis French; Sen. Bill Wielechowski; Sen. Linda Menard; Sen. Linda Menard; Sen. Lesil McGuire

Subject: SB23

All,

I urge each of you to vote for passage of SB23, which would reinstate the Tier III retirement program for State of Alaska employees hired after July 1, 2006. State employees have never been paid on par with their counterparts in private or federal positions. However, the old retirement program made up for some of the disparity.

As a tier IV employee with just over 2 years with ADEC, I see the constant turnover of personnel who can find better pay and benefits elsewhere. It must cost the State a great deal to constantly hire new personnel. If all State employees had a defined benefit retirement, I doubt there would be anywhere near the turnover as there now is.

Please endeavor to pass SB23. Thank you.

Ken Spiers

Anna Sorensen

From: Vaughan, Christine (DFG) [christine.vaughan@alaska.gov]
Sent: Wednesday, February 25, 2009 10:17 AM
To: Sen. Joe Paskvan
Subject: Defined Benefit Retirement
Importance: High

Joe,

In consideration of our children and all future state employees, please support the Defined Benefit plan. In addition to having recruitment problems, this generation has no incentive to stay with state government. We have become a training ground for the hard working, enthusiastic employees, who move on to higher pay and benefits. If we don't want a dull workforce engaged in supporting the state and its programs, please consider supporting the Defined Benefit plan for State Employees.

Thank you.

Christine Vaughan

F&G ADMINISTRATIVE OFFICER II
1300 College Road
Fairbanks, AK 99701
(907) 459-7253 phone (907) 452-4841 fax
christine.vaughan@alaska.gov

Anna Sorensen

From: Peter Bangs [pbangs@gmail.com]
Sent: Wednesday, February 25, 2009 10:17 AM
To: Sen. Joe Paskvan
Cc: Sen. Kim Elton; Sen. Joe Thomas; Sen. Bettye Davis; Sen. Kevin Meyer; Sen. Con Bunde
Subject: Comments on SB 23

Dear Senators,

I would like to take this opportunity to provide my input on SB23. I work for the Alaska Department of Fish & Game, though I am speaking for myself only and not ADF&G. I am a Tier 3 employee and my wife is a biologist with the Federal Government. If I were in your shoes, I would vote against SB23 because I think the DC system provides financial stability to the state and because I don't think it is the silver bullet for solving the recruitment and retention problems for the State. I will not dispute the fact that Tier I (particularly the 20-year police/fire retirement for many ADF&G employees) bought a lot of loyalty for the State. However, the real problem now is that biologists are often making about half of what their counterparts are making in the Federal Govt. If you want specific examples, I can provide them. The bulk of the federal employees retirement comes from their Thrift Savings Plan (TSP) which is like a 401K. They do receive a small pension, but it is pretty minimal. These Federal employees are not upset about this because they are paid well.

Of the ADF&G biologists that have been hired in the last 10 years, those with graduate degrees tend to not stick around long. Most of them were hired as Tier 3 employees, but they did not hesitate to give that up for a substantial pay raise. Of this group of well educated recent hires, those that remain are undoubtedly keeping their eyes open for Federal jobs. In many cases they can hardly afford not to. After my undergraduate and graduate education was complete, I was saddled with over \$100,000 in student loans. Most people in my position are not looking at jobs with ADF&G because they don't pay enough to make student loan payments on top of the high cost of living in Alaska.

I think the first thing that the State needs to do is to reevaluate the classification of biologists and biometricians in ADF&G. Does it seem reasonable that an Administrative Manager I position (that requires no college degree) is paid the same as a Biometrician I (where a Master's degree is required)?

Don't be fooled into thinking that SB23 is going to do anything to significantly improve the recruitment/retention problems at ADF&G. This problem will not go away until the State starts paying competitive wages for biologists and biometricians. Thank you for providing this opportunity for comment.

Sincerely,

Peter Bangs
2918 Simpson Ave
Juneau, AK 99801
790-1614

Anna Sorensen

From: Royse, Shannon R (DFG) [shannon.royse@alaska.gov]
Sent: Wednesday, February 25, 2009 10:44 AM
To: Sen. Con Bunde; Rep. Bob Lynn
Cc: Sen. Joe Paskvan; Sen. Bettye Davis; Sen. Kevin Meyer; Sen. Joe Thomas; Sen. Kim Elton; Sen. Johnny Ellis; Sen. Hollis French; Sen. Bill Wielechowski; Sen. Linda Menard; Sen. Joe Paskvan; Sen. Lesil McGuire; Sen. Joe Thomas
Subject: State employment, Retirement Plans, and Union activity

Dear Senator Bunde and Representative Lynn,

Below you will find a copy of an email I received this morning regarding Senate Bill 23. This is not the first email or post mail I have received regarding the subject of recruitment and retention of state employees.

I entered state service as a Tier III employee and when given the option to convert to a Defined Contribution Plan, after much thought and scrutiny, I decided to make the switch.

I am writing today because I consistently hear the Local 52 Union mantra of Fair Wages = Respect, that a guaranteed pension is critical for recruitment and retention and that these topics are why the state has a difficult time filling positions.

Sirs, with all due respect, I disagree. Fair wages, in fact, equal incentive, something state employees have not enjoyed for many years. Union bureaucracy rewards the long term employee regardless of their competence or merit. Talented and energetic employees are met with a stone wall of union longevity that prevents them from being rewarding with promotions or pay raises that would, in fact, be merit based.

Union Stewarts and employees who actually benefit from this outdated, outmoded and ineffective structure may fool themselves into believing that Senate Bill 23 will somehow improve recruitment and retention rates, but I believe this to be inherently false. I entered state service in order to give back to my community in some small way. Wages that are below a competitive market salary is a sacrifice that I knowingly made. This bill will do very little if anything to improve the State of Alaska's ability to recruit and retain high quality employees or affect my personal decision to remain with the state for a life time career. Competitive wages, advancement opportunities and fair treatment are the solutions the state must consider.

Thank you for your time.

Shannon Royse
 449 Dailey Ave., #17
 Anchorage AK 99515

*Shannon R. Royse
 Publications Tech. II
 ADF&G, Div. of Commercial Fisheries
 907-267-2414
 shannon.royse@alaska.gov*

From: Molyneaux, Doug B (DFG)

3/13/2009

Sent: Wednesday, February 25, 2009 5:54 AM

To: DFG - All Anchorage Staff; DFG - All Region 1 Divisions; DFG - All Nome Staff; DFG - All Kotzebue Staff; DFG - All Glennallen Staff; DFG - All Fairbanks Staff; DFG - All Delta Junction Staff; Seavoy, Roger J (DFG); Perry, Phillip L (DFG); Jones, Patrick W (DFG); Menard, James A (DFG); Hyer, Karen (OSM Biometrician); Witteveen, Mark J (DFG); Martz, Michael U (DEC); Hart, Deborah A (DFG); Hilsinger, John R (DFG); Volk, Eric C (DFG); DEC EVERYONE - Wasilla; DEC EVERYONE - Fairbanks; DEC EVERYONE - 410 Willoughby; DEC EVERYONE - 555 Cordova; DEC EVERYONE - Anchorage Bayview; DEC EVERYONE - Anchorage Lab; DEC EVERYONE - Kenai; DEC EVERYONE - Ketchikan; DEC EVERYONE - Valdez; DEC EVERYONE - Wasilla; DFG - HAB Palmer Staff; dfg.dcf.KodiakSalmon.Admins; DNR ACMP Supervisors; DPS AST RECRUITMENT; HSS All ALP JNU PH Staff; HSS All ALP KTN PH Staff; HSS ALL ALP SIT PH Staff; HSS All DBH Fairbanks Staff; HSS All DPH Nursing Statewide; HSS DJJ Bethel; HSS DJJ Fairbanks; HSS DJJ Mat-Su; HSS DPA Bethel Staff; HSS DPA Mat-Su ESS; HSS OCS Wasilla All Office Staff

Subject: Repeal Defined Contributions Retirement Plans (Tier IV) - Senate Hearing Thursday

ACTION REQUESTED

To All:

The Senate Labor and Commerce Committee will be meeting on Thursday 26 February at 1:30 p.m. to discuss **Senate Bill 23**, which seeks to repeal the **Defined Contribution Retirement Plan (Tier IV)** and replace it with a **Defined Benefits Retirement Plan (Tier III)** that **guarantees a pension** for state employees at retirement. This is a critical change for all State employees that are in the Tier IV program (hired after 30 June 2006), and for the future of being able to recruit and retain high quality state employees. The Thursday meeting is likely to be when the committee will decide whether the bill is forwarded to the full Senate or not.

Please contact your State Senator, members of the Senate Labor and Commerce Committee, and Senate Sponsors of SB 23 **today** to express your position. Just a one paragraph e-mail that informs them who you are and your position will suffice. If you are Tier IV, let them know that the Defined Contribution Retirement Plan provides little incentive for you to continue as a State public employee. If you are Tier I, II, or III, let them know about your concern for recruitment and retention of employees.

1. Your State Senator (**Email Address:** Senator_First Name_Last Name@legis.state.ak.us.)
2. Senate Labor and Commerce Committee Members:
 - CHAIR: Senator Joe Paskvan
(Senator_Joe_Paskvan@legis.state.ak.us)
 - VICE-CHAIR: Senator Joe Thomas
(Senator_Joe_Thomas@legis.state.ak.us)
 - MEMBER: Senator Bettye Davis
(Senator_Bettye_Davis@legis.state.ak.us)
 - MEMBER: Senator Kevin Meyer
(Senator_Kevin_Meyer@legis.state.ak.us)
 - MEMBER: Senator Con Bunde
(Senator_Con_Bunde@legis.state.ak.us)
3. Senate Bill 23 Sponsors:
 - ELTON, (Senator_Kim_Elton@legis.state.ak.us)
 - Ellis, (Senator_Johnny_Ellis@legis.state.ak.us)
 - French, (Senator_Hollis_French@legis.state.ak.us)

Wielechowski, (Senator_Bill_Wielechowski@legis.state.ak.us)
Menard, (Senator_Linda_Menard@legis.state.ak.us)
Paskvan, (Senator_Joe_Paskvan@legis.state.ak.us)
McGuire, (Senator_Lesil_Mcguire@legis.state.ak.us)
Thomas, (Senator_Joe_Thomas@legis.state.ak.us)

Below is the e-mail I sent earlier this morning:

Subject Line: SB23 Repeal of Defined Contributions

Senator Paskvan and Members of the Senate Labor
and Commerce Committee:

Thank you for the opportunity last week to provide testimony in support of SB 23, which seeks to repeal the Defined Contribution Retirement Plan in place of a Defined Benefits Retirement Plan that guarantees new state employees with a pension at retirement. The move to a Defined Contribution Retirement Plan in 2006 was an experiment that failed, and it contributes significantly to our difficulties with recruitment and retention of employees. I ask that you right this wrong by supporting SB 23 and moving it out of committee when you meet on Thursday, 26 February.

Thank you.

SPONSOR(s): SENATOR(S) ELTON, Ellis, French, Wielechowski, Menard, Paskvan, McGuire, Thomas, Davis

HEARING: (S) L&C Feb 26 1:30 PM BELTZ 211 TELECONFERENCE

TITLE: "An Act repealing the defined contribution retirement plans for teachers and for public employees; providing a defined benefit retirement plan for teachers and public employees; making conforming amendments; and providing for an effective date."

From: Molyneaux, Doug B (DFG)

Sent: Sunday, February 22, 2009 3:25 PM

To: DFG - All Anchorage Staff; DFG - All Region 1 Divisions; DFG - All Nome Staff; DFG - All Kotzebue Staff; DFG - All Glennallen Staff; DFG - All Fairbanks Staff; DFG - All Delta Junction Staff; Seavoy, Roger J (DFG); Perry, Phillip L (DFG); Jones, Patrick W (DFG)

Subject: Repeal Defined Contributions Retirement Plans (Tier IV) - Senate Hearing Audio

Break Time News

To All:

This past Thursday I was in Juneau to provide testimony at a Senate hearing to repeal the Defined Contribution Retirement Plan (Tier IV), and I felt I should provide you with some

3/13/2009

follow-up.

4. You can listen to the actual 60 minute hearing at: Senate Labor and Commerce Committee (in case the link is broken, Goggle “Gavel to Gavel Alaska”, and go to Podcast; Recorded: Senate Labor and Commerce Committee 19 Feb 09 1:30 pm). There was some excellent and informative testimony.

When listening, it may be handy to realize

“DB” = Defined Benefits – includes a guaranteed pension as under Tier III.

“DC” = Defined Contribution – no pension, as it is under Tier IV

The Senate Committee will be meeting again on this issue some time this week and possibly vote whether to move the bill on.

5. Senate Labor and Commerce Committee Members:

CHAIR: Senator Joe Paskvan

VICE-CHAIR: Senator Joe Thomas

MEMBER: Senator Bettye Davis

MEMBER: Senator Kevin Meyer

MEMBER: Senator Con Bunde

6. If you recall back to your high school civics class, bills are developed in both the House and Senate side of the State Legislature. For this particular issue, there are both a Senate and two House bills in play.
 - a. **Senate Bill 23 is sponsored by Senator Kim Elton.**
 - b. **House Bill 30 sponsored by Representatives John Harris, Mike Hawker, and Cathy Munoz;**
 - c. **House Bill 54 is sponsored by Representatives Chris Tuck, Harry Crawford, Bob Buch, Sharon Cissna, Les Gara, Lindsey Holmes, and Pete Petersen.**

House of Representative Labor and Commerce Committee Members who will be working on these bills are:

CHAIR: Representative Kurt Olson

VICE-CHAIR: Representative Mark Neuman

MEMBER: Representative Mike Chenault

MEMBER: Representative John Coghill

MEMBER: Representative Bob Lynn

MEMBER: Representative Bob Buch

MEMBER: Representative Lindsey Holmes

7. What You Can Do: communicate with the legislators so they know your views and concerns. They need feed back and guidance from you if they are to adequately represent you. Key folks you should consider contacting are:
 - a. bill sponsors,
 - b. committee members
 - c. and your own Senator and Representative who will ultimately be voting on the bills if they get through the committees.

Information on how to contact legislators can be found at

<http://w3.legis.state.ak.us/index.php>. All Legislative mail during the legislative session goes to the same place:

Representative XXX, or Senator XXX
State Capitol
Juneau AK 99801

There is no need to go into great detail and present yourself as an expert on the intricacy of the retirement programs. The general format is to introduce yourself, hit on your own experience, the experience of your co-workers, and what these experiences mean to the health of your department and the programs within it. This issue is to repeal Tier IV, which would replace it with Tier III.

For more background information you can find a table to compare Tier III to Tier IV at the following web site: <http://www.state.ak.us/drb/pers/perstieri-ivchart.pdf>

Please feel free to forward this e-mail to any State employee that may be interested.

Douglas B. Molyneaux

Fishery Biologist
Commercial Fisheries Division, Kuskokwim Area
Alaska Dept. of Fish and Game

Winter (Anchorage):
333 Raspberry Road
Anchorage, AK 99518
Phone: 907-267-2397

Summer (Bethel):
P.O. box 1467
Bethel, AK 99559
(907) 543-2792

Anna Sorensen

From: Bryn Hiner [bryn.hiner@gmail.com]

Sent: Wednesday, February 25, 2009 10:17 AM

To: Sen. Joe Paskvan; Sen. Joe Thomas; Sen. Bettye Davis; Sen. Kevin Meyer; Sen. Con Bunde; Sen. Kim Elton; Sen. Johnny Ellis; Sen. Hollis French; Sen. Bill Wielechowski; Sen. Linda Menard; Sen. Lesil McGuire

Subject: Repeal Defined Contributions Retirement

thank you for your consideration to repeal Tier IV Defined Contributions Retirement and replace with a Defined Benefits Retirement Plan

Bryn Hiner
Tier IV hired July 2008
Administrative Clerk Alaska Department of Fish & Game
Division of Habitat
Anchorage

Anna Sorensen

From: Ali Gaines [ali_gaines@hotmail.com]

Sent: Wednesday, February 25, 2009 10:09 AM

To: Sen. Joe Paskvan; Sen. Joe Thomas; Sen. Bettye Davis; Sen. Kevin Meyer; Sen. Con Bunde

Subject: SB 23 Repeal of Defined Contributions

Senator Paskvan and Members of the Senate Labor and Commerce Committee:

I am writing to ask that you support SB 23 and move it out of committee when you meet on Thursday, 26 February. As a Tier IV employee there is no incentive for me to stay with the State of Alaska. Passing SB 23 would greatly influence the recruitment and retention of State employees.

Thank you,

Alison S. Gaines, RN, BSN

Public Health Nurse

Juneau Public Health Center

Access your email online and on the go with Windows Live Hotmail. [Sign up today.](#)

Anna Sorensen

From: Pace, Susan M (DFG) [susan.pace@alaska.gov]
Sent: Wednesday, February 25, 2009 10:14 AM
To: Sen. Joe Paskvan; Sen. Joe Thomas; Sen. Bettye Davis; Sen. Kevin Meyer; Sen. Con Bunde
Subject: SB23 Repeal of Defined Contributions

Senator Paskvan and Members of the Senate Labor and Commerce Committee:

Thank you for the opportunity last week to provide testimony in support of SB 23, which seeks to repeal the Defined Contribution Retirement Plan in place of a Defined Benefits Retirement Plan that guarantees new state employees with a pension at retirement. The move to a Defined Contribution Retirement Plan in 2006 was an experiment that failed, and it contributes significantly to our difficulties with recruitment and retention of employees. I ask that you right this wrong by supporting SB 23 and moving it out of committee when you meet on Thursday, 26 February.

Thank you,
Susan Pace

Anna Sorensen

From: Zachary Liller [zwliller@yahoo.com]
Sent: Wednesday, February 25, 2009 9:36 AM
To: Sen. Joe Paskvan; Sen. Joe Thomas; Sen. Bettye Davis; Sen. Kevin Meyer; Sen. Con Bunde
Subject: SB23 Repeal of Defined Contributions

Members of the Senate Labor and Commerce Committee:

I am a Fisheries Biologist with the Alaska Department of Fish and Game. I ask that you support SB23, which seeks to repeal the Defined Contribution Retirement Plan in place of a Defined Benefits Retirement Plan that guarantees new state employees with a pension at retirement. The move to a Defined Contribution Retirement Plan in 2006 has proved to be an experiment that failed. This failure has resulted in an uncertainty about the future for many of the young up-and-coming State biologists; the very same people who will be charged with protecting our natural resources for years to come. The current retirement system provides no incentive for new employees to continue with State service and has contributed significantly to our difficulties with recruitment of new talented employees. I encourage you to right this wrong, by moving SB23 out of committee when you meet on Thursday, 26 February.

Zachary W. Liller

Fisheries Research Biologist
Kuskokwim Area

Alaska Department of Fish and Game
Commercial Fisheries Division
333 Raspberry Road
Anchorage, AK 99518
Phone: 907-267-2380
Fax: 907-267-2442

Anna Sorensen

From: Zachary Liller [zwliller@yahoo.com]
Sent: Wednesday, February 25, 2009 9:40 AM
To: Sen. Kim Elton; Sen. Johnny Ellis; Sen. Hollis French; Sen. Bill Wielechowski; Sen. Linda Menard;
Sen. Joe Paskvan; Sen. Lesil McGuire; Sen. Joe Thomas
Subject: SB23 Repeal of Defined Contributions

Senate Bill 23 Sponsors:

I am a Fisheries Biologist with the Alaska Department of Fish and Game. I thank you for sponsoring SB23, which seeks to repeal the Defined Contribution Retirement Plan in place of a Defined Benefits Retirement Plan that guarantees new state employees with a pension at retirement. The move to a Defined Contribution Retirement Plan in 2006 has proved to be an experiment that failed. This failure has resulted in an uncertainty about the future for many of the young up-and-coming State biologists; the very same people who will be charged with protecting our natural resources for years to come. The current retirement system provides no incentive for new employees to continue with State service and has contributed significantly to our difficulties with recruitment of new talented employees. I encourage you to continue your efforts to right this wrong, by moving SB23 out of committee when you meet on Thursday, 26 February.

Zachary W. Liller

Fisheries Research Biologist
Kuskokwim Area

Alaska Department of Fish and Game
Commercial Fisheries Division
333 Raspberry Road
Anchorage, AK 99518
Phone: 907-267-2380
Fax: 907-267-2442

Anna Sorensen

From: Hildebrand, Heather L (DFG) [heather.hildebrand@alaska.gov]

Sent: Wednesday, February 25, 2009 9:19 AM

To: Sen. Joe Paskvan

Subject: Repeal Defined Contributions Retirement Plan (Tier IV)

Dear Senator Paskvan,

I am a Fisheries Biologist with the Alaska Department of Fish and Game (ADF&G), Commercial Fisheries Division and have been working for the State for the past 2 years. I had moved to Alaska after graduate school with my boyfriend with the hope of building a life and career; however, with the current Tier IV retirement plan, I have no incentive to continue as a State employee after I become vested. My boyfriend began working for ADF&G in 2006 and was able to get in "under the wire" and is Tier III; however, we won't be able to live off of his retirement alone when the time comes. Our current plan is to hold off on buying a house; which I had hoped to do by now, save as much money as we can, and move back down to the lower 48 after I become vested.

I'm writing to you today to request that you support SB 23 and repeal the Defined Contribution Retirement Plan and move it out of committee on Thursday. Alaska should be more than just a training ground for fisheries professionals. Employees should be rewarded for devoting their lives to their jobs, instead of being punished for staying too long.

Sincerely,

Heather Hildebrand

Heather Hildebrand

333 Raspberry Rd.
Anchorage, AK 99518
(907) 267-2118-phone
(907) 267-2442-fax

Anna Sorensen

From: Clemens, Pamela Y (DEC) [pam.clemens@alaska.gov]

Sent: Wednesday, February 25, 2009 9:19 AM

To: Sen. Joe Paskvan; Sen. Joe Thomas; Sen. Bettye Davis; Sen. Kevin Meyer; Sen. Con Bunde

As a tier IV State employee I hope that you will support of SB 23, which seeks to repeal the Defined Contribution Retirement Plan in place of a Defined Benefits Retirement Plan that guarantees new state employees with a pension at retirement. The move to a Defined Contribution Retirement Plan in 2006 was an experiment that failed, and it contributes significantly to the difficulties with recruitment and retention of employees. I ask that you support SB 23 and move it out of committee when you meet on Thursday, 26 February.

I am a life-long Alaskan that had always worked in non-profit organizations until I took a position in December of 2006 with the Department of Environmental Conservation. I was shocked to learn that my retirement plan, as a tier IV member, would not provide for me when I retire. Please allow SB 23 to go before the full Senate and support is there as well.

Thanks for helping your fellow Alaskan's have a better quality of life when they retire.

Sincerely, Pamela Y. Clemens

Anna Sorensen

From: Mark Sielaff [mjsielaff@gmail.com]

Sent: Wednesday, February 25, 2009 9:19 AM

To: Sen. Joe Paskvan; Sen. Joe Thomas; Sen. Bettye Davis; Sen. Kevin Meyer; Sen. Con Bunde; Sen. Kim Elton; Sen. Johnny Ellis; Sen. Hollis French; Sen. Bill Wielechowski; Sen. Linda Menard; Sen. Lesil McGuire

Subject: Senate Bill 23, which seeks to repeal the Defined Contribution Retirement Plan (Tier IV)

Senators:

I hope you seek to repeal the Defined Contribution Retirement Plan (tier IV) and replace it with a Defined Benefits Retirement Plan (Tier III), that guarantees new state employees with a pension at retirement.

The move to a Defined Contribution Retirement Plan in 2006 was not in the best interest of new employees contributing significantly to state difficulties with recruitment and retention of employees. I ask that you right this wrong by supporting SB 23 and moving it out of committee when you meet on Thursday, February 26, 2009.

As a Tier IV employee who has over 20 years of prior emergency response experience with the United States Coast Guard, I have found my work with the State as an emergency responder to be rewarding and enjoyable. The reduced salary and lack of pension at retirement is a major setback in retaining my job with the state as well as offers from other federal and local employers. The failure of the state to keep in step with federal and public jobs has forced many of us to look elsewhere. With my supervisor soon taking a promotion I will be the only member left of five since November 16, 2006 to retain this job. State jobs have turn into stepping stone for better jobs in the community. The failure of the state to retain personnel will result in future problems of retaining qualified individuals.

Mark J. Sielaff
Alaska Department Of Environmental Conservation
Environmental Program Specialist III
Home Phone: 907-745-0455

Anna Sorensen

From: Kimball, Heath T (DFG) [heath.kimball@alaska.gov]
Sent: Wednesday, February 25, 2009 9:18 AM
To: Sen. Joe Paskvan; Sen. Joe Thomas; Sen. Bettye Davis; Sen. Kevin Meyer; Sen. Con Bunde
Subject: SB23 Repeal of Defined Contribution Retirement Plan

Members of the Senate Labor and Commerce Committee:

My name is Heath Kimball and I am an Analyst Programmer for the Department of Fish and Game. I am Tier IV and this Defined Contribution Retirement Plan is not an incentive to keep me working for the State. The State of Alaska is behind the curve when it comes to salary for software programmers. A good retirement and salary are the two largest incentives for employees. The State lacks in both of them. With the Tier IV retirement and lower salaries the State cannot compete with the private sector. To improve the recruitment and retention of quality employees the State must revert to Tier III.

Heath Kimball
Analyst Programmer
Dept. Fish and Game

Anna Sorensen

From: Kvasnicka, Sarah L (DEC) [sarah.kvasnicka@alaska.gov]
Sent: Wednesday, February 25, 2009 9:14 AM
To: Sen. Joe Paskvan
Subject: Repeal Defined Contributions Retirement Plans (Tier IV) - Senate Hearing Thursday

Dear Mr. Paskvan,

I am a new hire at the Department of Environmental Conservation's Division of Water. I have been employed with the State of Alaska exactly one month. I enjoy the work very much. However, after reading about the Tier IV Retirement Plan, I became very disappointed. I had assumed when accepting the position that the State of Alaska would provide its employees with adequate benefits, which is not the case.

Because the parameters of the Tier IV program are not conducive to a long-term career, I see my employment with the State of Alaska as a temporary experience. My employment with the state is simply a learning experience and a stepping stone that will make me more employable elsewhere. I cannot afford to invest years of my career into the current system.

The position that I hold is the first level of the professional series, which requires a bachelor's degree in science and several years on the job experience. This position has gone through several employees just within the last five years. I think this is just one of many signs that the parameters in the Tier IV package need to be revised.

Sarah L. Kvasnicka
 Environmental Program Specialist II
 Department of Environmental Conservation
 Division of Water
 610 University Avenue
 Fairbanks, Alaska 99709
 PH: (907) 451-2106
 FX: (907) 451-2187

From: Molyneaux, Doug B (DFG)
Sent: Wednesday, February 25, 2009 5:54 AM
To: DFG - All Anchorage Staff; DFG - All Region 1 Divisions; DFG - All Nome Staff; DFG - All Kotzebue Staff; DFG - All Glennallen Staff; DFG - All Fairbanks Staff; DFG - All Delta Junction Staff; Seavoy, Roger J (DFG); Perry, Phillip L (DFG); Jones, Patrick W (DFG); Menard, James A (DFG); Hyer, Karen (OSM Biometrician); Witteveen, Mark J (DFG); Martz, Michael U (DEC); Hart, Deborah A (DFG); Hilsinger, John R (DFG); Volk, Eric C (DFG); DEC EVERYONE - Wasilla; DEC EVERYONE - Fairbanks; DEC EVERYONE - 410 Willoughby; DEC EVERYONE - 555 Cordova; DEC EVERYONE - Anchorage Bayview; DEC EVERYONE - Anchorage Lab; DEC EVERYONE - Kenai; DEC EVERYONE - Ketchikan; DEC EVERYONE - Valdez; DEC EVERYONE - Wasilla; DFG - HAB Palmer Staff; dfg.dcf.KodiakSalmon.Admins; DNR ACMP Supervisors; DPS AST RECRUITMENT; HSS All ALP JNU PH Staff; HSS All ALP KTN PH Staff; HSS ALL ALP SIT PH Staff; HSS All DBH Fairbanks Staff; HSS All DPH Nursing Statewide; HSS DJJ Bethel; HSS DJJ Fairbanks; HSS DJJ Mat-Su; HSS DPA Bethel Staff; HSS DPA Mat-Su ESS; HSS OCS Wasilla All Office Staff
Subject: Repeal Defined Contributions Retirement Plans (Tier IV) - Senate Hearing Thursday

ACTION REQUESTED

3/13/2009

To All:

The Senate Labor and Commerce Committee will be meeting on Thursday 26 February at 1:30 p.m. to discuss **Senate Bill 23**, which seeks to repeal the **Defined Contribution Retirement Plan (Tier IV)** and replace it with a **Defined Benefits Retirement Plan (Tier III)** that **guarantees a pension** for state employees at retirement. This is a critical change for all State employees that are in the Tier IV program (hired after 30 June 2006), and for the future of being able to recruit and retain high quality state employees. The Thursday meeting is likely to be when the committee will decide whether the bill is forwarded to the full Senate or not.

Please contact your State Senator, members of the Senate Labor and Commerce Committee, and Senate Sponsors of SB 23 **today** to express your position. Just a one paragraph e-mail that informs them who you are and your position will suffice. If you are Tier IV, let them know that the Defined Contribution Retirement Plan provides little incentive for you to continue as a State public employee. If you are Tier I, II, or III, let them know about your concern for recruitment and retention of employees.

1. Your State Senator (Email Address: Senator_First Name_Last Name@legis.state.ak.us.)

2. Senate Labor and Commerce Committee Members:

CHAIR: Senator Joe Paskvan
(Senator_Joe_Paskvan@legis.state.ak.us)

VICE-CHAIR: Senator Joe Thomas
(Senator_Joe_Thomas@legis.state.ak.us)

MEMBER: Senator Bettye Davis
(Senator_Bettye_Davis@legis.state.ak.us)

MEMBER: Senator Kevin Meyer
(Senator_Kevin_Meyer@legis.state.ak.us)

MEMBER: Senator Con Bunde
(Senator_Con_Bunde@legis.state.ak.us)

3. Senate Bill 23 Sponsors:

ELTON, (Senator_Kim_Elton@legis.state.ak.us)

Ellis, (Senator_Johnny_Ellis@legis.state.ak.us)

French, (Senator_Hollis_French@legis.state.ak.us)

Wielechowski, (Senator_Bill_Wielechowski@legis.state.ak.us)

Menard, (Senator_Linda_Menard@legis.state.ak.us)

Paskvan, (Senator_Joe_Paskvan@legis.state.ak.us)

McGuire, (Senator_Lesil_Mcguire@legis.state.ak.us)

Thomas, (Senator_Joe_Thomas@legis.state.ak.us)

Below is the e-mail I sent earlier this morning:

Subject Line: SB23 Repeal of Defined Contributions

Senator Paskvan and Members of the Senate Labor
and Commerce Committee:

Thank you for the opportunity last week to provide

testimony in support of SB 23, which seeks to repeal the Defined Contribution Retirement Plan in place of a Defined Benefits Retirement Plan that guarantees new state employees with a pension at retirement. The move to a Defined Contribution Retirement Plan in 2006 was an experiment that failed, and it contributes significantly to our difficulties with recruitment and retention of employees. I ask that you right this wrong by supporting SB 23 and moving it out of committee when you meet on Thursday, 26 February.

Thank you.

SPONSOR(s): SENATOR(S) ELTON, Ellis, French, Wielechowski, Menard, Paskvan, McGuire, Thomas, Davis
HEARING: (S) L&C Feb 26 1:30 PM BELTZ 211 TELECONFERENCE

TITLE: "An Act repealing the defined contribution retirement plans for teachers and for public employees; providing a defined benefit retirement plan for teachers and public employees; making conforming amendments; and providing for an effective date."

From: Molyneaux, Doug B (DFG)

Sent: Sunday, February 22, 2009 3:25 PM

To: DFG - All Anchorage Staff; DFG - All Region 1 Divisions; DFG - All Nome Staff; DFG - All Kotzebue Staff; DFG - All Glennallen Staff; DFG - All Fairbanks Staff; DFG - All Delta Junction Staff; Seavoy, Roger J (DFG); Perry, Phillip L (DFG); Jones, Patrick W (DFG)

Subject: Repeal Defined Contributions Retirement Plans (Tier IV) - Senate Hearing Audio

Break Time News

To All:

This past Thursday I was in Juneau to provide testimony at a Senate hearing to repeal the Defined Contribution Retirement Plan (Tier IV), and I felt I should provide you with some follow-up.

4. You can listen to the actual 60 minute hearing at: [Senate Labor and Commerce Committee](#) (in case the link is broken, Goggle "Gavel to Gavel Alaska", and go to Podcast; Recorded: Senate Labor and Commerce Committee 19 Feb 09 1:30 pm). There was some excellent and informative testimony.

When listening, it may be handy to realize

"DB" = Defined Benefits – includes a guaranteed pension as under Tier III.

"DC" = Defined Contribution – no pension, as it is under Tier IV

The Senate Committee will be meeting again on this issue some time this week and possibly vote whether to move the bill on.

5. Senate Labor and Commerce Committee Members:

CHAIR: Senator Joe Paskvan
 VICE-CHAIR: Senator Joe Thomas
 MEMBER: Senator Bettye Davis
 MEMBER: Senator Kevin Meyer
 MEMBER: Senator Con Bunde

6. If you recall back to your high school civics class, bills are developed in both the House and Senate side of the State Legislature. For this particular issue, there are both a Senate and two House bills in play.

- a. **Senate Bill 23 is sponsored by Senator Kim Elton.**
- b. **House Bill 30 sponsored by Representatives John Harris, Mike Hawker, and Cathy Munoz;**
- c. **House Bill 54 is sponsored by Representatives Chris Tuck, Harry Crawford, Bob Buch, Sharon Cissna, Les Gara, Lindsey Holmes, and Pete Petersen.**

House of Representative Labor and Commerce Committee Members who will be working on these bills are:

CHAIR: Representative Kurt Olson
 VICE-CHAIR: Representative Mark Neuman
 MEMBER: Representative Mike Chenault
 MEMBER: Representative John Coghill
 MEMBER: Representative Bob Lynn
 MEMBER: Representative Bob Buch
 MEMBER: Representative Lindsey Holmes

7. What You Can Do: communicate with the legislators so they know your views and concerns. They need feed back and guidance from you if they are to adequately represent you. Key folks you should consider contacting are:

- a. bill sponsors,
- b. committee members
- c. and your own Senator and Representative who will ultimately be voting on the bills if they get through the committees.

Information on how to contact legislators can be found at <http://w3.legis.state.ak.us/index.php>. All Legislative mail during the legislative session goes to the same place:

Representative XXX, or Senator XXX
 State Capitol
 Juneau AK 99801

There is no need to go into great detail and present yourself as an expert on the intricacy of the retirement programs. The general format is to introduce yourself, hit on your own experience, the experience of your co-workers, and what these experiences mean to the health of your department and the programs within it. This issue is to repeal Tier IV, which would replace it with Tier III.

For more background information you can find a table to compare Tier III to Tier IV at the following web site: <http://www.state.ak.us/drb/pers/perstieri-ivchart.pdf>

Please feel free to forward this e-mail to any State employee that may be interested.

Douglas B. Molyneaux

Fishery Biologist
Commercial Fisheries Division, Kuskokwim Area
Alaska Dept. of Fish and Game

Winter (Anchorage):
333 Raspberry Road
Anchorage, AK 99518
Phone: 907-267-2397

Summer (Bethel):
P.O. box 1467
Bethel, AK 99559
(907) 543-2792

Anna Sorensen

From: Dallman, Nicholas E (DEC) [nicholas.dallman@alaska.gov]
Sent: Wednesday, February 25, 2009 8:57 AM
To: Molyneaux, Doug B (DFG); Sen. Joe Paskvan; Sen. Joe Thomas; Sen. Bettye Davis; Sen. Kevin Meyer; Sen. Con Bunde
Cc: Sen. Kim Elton; Sen. Johnny Ellis; Sen. Hollis French; Sen. Bill Wielechowski; Sen. Linda Menard; Sen. Joe Paskvan; Sen. Lesil McGuire; Sen. Joe Thomas
Subject: SB23 Repeal of Defined Contributions

Senator Paskvan and Members of the Senate Labor and Commerce Committee:

Thank you for the opportunity to provide testimony in support of SB 23, which seeks to repeal the Defined Contribution Retirement Plan in place of a Defined Benefits Retirement Plan that guarantees new state employees with a pension at retirement. The move to a Defined Contribution Retirement Plan in 2006 was an experiment that failed, and it contributes significantly to our difficulties with recruitment and retention of employees. I ask that you right this wrong by supporting SB 23 and moving it out of committee when you meet on Thursday, 26 February.

Thank you.

Anna Sorensen

From: Caldentey, Iris C O (DFG) [iris.caldentey@alaska.gov]
Sent: Wednesday, February 25, 2009 8:50 AM
To: Sen. Joe Paskvan
Cc: Sen. Joe Thomas; Sen. Bettye Davis; Sen. Kevin Meyer; Sen. Con Bunde; Sen. Kim Elton; Sen. Johnny Ellis; Sen. Hollis French; Sen. Bill Wielechowski; Sen. Linda Menard; Sen. Joe Paskvan; Sen. Lesil McGuire
Subject: SB23 Repeal of Defined Contributions

Senator Paskvan and Members of the Senate Labor and Commerce Committee:

I was hired on with the State of Alaska Department of Fish and Game in August of 2006. I believe that the Defined Contribution Retirement Plan provides little incentive for me, or any new hires to continue as a State public employee. The State moved to a Defined Contribution Retirement Plan in 2006 and the plan failed. I also believe it contributes significantly to our difficulties with recruitment and retention of valuable, educated employees, including myself. I ask that you right this wrong by supporting SB 23 and moving it out of committee when you meet on Thursday, 26 February.

Thank you for your time.
Sincerely,

Iris C.O. Caldentey
Fishery Biologist
211 Mission Rd.
Kodiak, AK. 99615
(907) 486-1810
k(((((> k(((((>

Anna Sorensen

From: Bentley, Marc H (DEC) [marc.bentley@alaska.gov]

Sent: Wednesday, February 25, 2009 8:50 AM

To: Sen. Joe Paskvan

Subject: SB23 Repeal of Defined Contributions

Senator Paskvan and Members of the Senate Labor
and Commerce Committee:

Thank you for the opportunity last week to provide testimony in support of SB 23, which seeks to repeal the Defined Contribution Retirement Plan in place of a Defined Benefits Retirement Plan that guarantees new state employees with a pension at retirement. The move to a Defined Contribution Retirement Plan in 2006 was an experiment that failed, and it contributes significantly to our difficulties with recruitment and retention of employees. I ask that you right this wrong by supporting SB 23 and moving it out of committee when you meet on Thursday, 26 February.

Marc H. Bentley, M.S.
Environmental Program Specialist III
Industrial Wastewater Permitting
Alaska Dept. of Environmental Conservation

Anna Sorensen

From: Buck.George@neaalaska.org
Sent: Wednesday, February 25, 2009 8:47 AM
To: Sen. Joe Paskvan
Subject: SB 23
Follow Up Flag: Follow up
Flag Status: Red

Dear Joe,

SB 23 has now been heard twice in Labor and Commerce but has not yet been passed out of committee. I have been informed that it is your intent to introduce an amended or somehow altered form of this Bill.

Joe, we have 9 of 20 Senators and 17 of 40 Representatives sponsoring this Bill in either the SB or HB form. It is way too early in the process to begin introducing changes.

Your friends in Fairbanks supported your commitment to return to Defined Benefit Retirement System. To hear now that you are intending to propose a Hybrid is very disconcerting.

Please pass SB 23 out of committee in its original, and unchanged, form.

Sincerely,

Buck George

Anna Sorensen

From: Bentley, Marc H (DEC) [marc.bentley@alaska.gov]
Sent: Wednesday, February 25, 2009 8:41 AM
To: Sen. Joe Paskvan
Subject: SB23 Repeal of Defined Contributions

Senator Paskvan and Members of the Senate Labor and Commerce Committee:

Thank you for the opportunity last week to provide testimony in support of SB 23, which seeks to repeal the Defined Contribution Retirement Plan in place of a Defined Benefits Retirement Plan that guarantees new state employees with a pension at retirement. The move to a Defined Contribution Retirement Plan in 2006 was an experiment that failed, and it contributes significantly to our difficulties with recruitment and retention of employees. I ask that you right this wrong by supporting SB 23 and moving it out of committee when you meet on Thursday, 26 February.

Marc H. Bentley, M.S.
Environmental Program Specialist III
Industrial Wastewater Permitting
Alaska Dept. of Environmental Conservation

Anna Sorensen

From: Kent, Scott M (DFG) [scott.kent@alaska.gov]
Sent: Wednesday, February 25, 2009 8:41 AM
To: Sen. Joe Paskvan
Subject: Bill 23

Senator Paskvan and Members of the Senate Labor and Commerce Committee:

I'm writing you to ask that you please support SB 23. High quality Fish & Game employees, particularly in the Biologist series have been difficult to recruit and retain in recent years, largely due to salaries that are not commensurate with the responsibilities that these positions require. Our federal counterparts have smaller work loads and make a better wage than we do. As a consequence of non-competitive salaries and Tier IV, we are losing a large amount of the department's institutional knowledge concerning responsible fish & wildlife management. These experienced employees have retired or moved over to the feds before being able to train new qualified applicants because of an inability to fill these positions. Tier IV has greatly exacerbated this problem by further reducing the incentive to work for the State of Alaska. If the Department of Fish & Game, as well as other departments, are going to be able to provide the services that the public expects of us, we need to be able to attract and retain highly qualified candidates for these positions. Repealing Tier IV would be a good start toward this goal. Thank you.

Scott M. Kent
Arctic Region Assistant Area Manager
Norton Sound - Port Clarence - Kotzebue
Alaska Dept. Fish & Game
Nome, AK 99762
(907) 443-5167

Anna Sorensen

From: Jennings, Latrisha S (DEC) [latrisha.jennings@alaska.gov]

Sent: Wednesday, February 25, 2009 8:39 AM

To: Sen. Joe Paskvan

Subject: SB23 Repeal of Defined Contributions

Thank you for the opportunity to provide support of SB 23, which seeks to repeal the Defined Contribution Retirement Plan in place of a Defined Benefits Retirement Plan that guarantees new state employees with a pension at retirement, and I hope existing employees hired after June 2006 will benefit as well. The move to a Defined Contribution Retirement Plan in 2006 was an experiment that failed. I ask that you right this wrong by supporting SB 23 and moving it out of committee when you meet on Thursday, 26 February.

Latrisha S. Jennings

Administrative Clerk III
Environmental Conservation
Spill Prevention and Response Division
Contaminated Sites Program
(907) 451-2153

latrisha.jennings@alaska.gov

Anna Sorensen

From: Amundson, Tyler G (DFG) [tyler.amundson@alaska.gov]
Sent: Wednesday, February 25, 2009 8:17 AM
To: Sen. Joe Paskvan
Subject: SB23 Repeal of Defined Contributions

Senator Paskvan,

My name is Tyler Amundson I am twenty-two and was born and raised in Fairbanks Alaska. I was hired on November 5th, 2008 as an Accounting Tech for Fish & Game in Fairbanks. Sadly this puts me in Tier IV and although I love my job and the people I work with every time I look at my retirement it provides little incentive for me to stay and a lot of incentive for me to leave. Thank you for time and ask that you support SB 23 and move it out of committee when you meet on Thursday, 26 February.

Thank you,
Tyler Amundson

3/13/2009

Anna Sorensen

From: Yap, Jimmy N (DEC) [jimmy.yap@alaska.gov]
Sent: Wednesday, February 25, 2009 8:18 AM
To: Sen. Joe Paskvan; Sen. Joe Thomas; Sen. Bettye Davis; Sen. Kevin Meyer; Sen. Con Bunde
Cc: douglas.molyneaux@alaska.gov
Subject: SB23 Repeal of Defined Contributions

Our division at Air Quality (ADEC) is among those which boast of experts in their field, near their retirement age and possess vast knowledge and skills that they can transfer to new hires. They are still working for the state because they are assured of good retirement benefits. I am getting the best training in the world as a new hire because of their expertise. In the future, if we don't have high quality employees like them, who will train the next generation of state workers as good as only they could?

With the Defined Contribution Retirement Plan, there will be high volume of employees coming in and out, and it contributes significantly to difficulties with recruitment and retention of employees.

Please support SB23 to correct the experiment done on having a Defined Contribution Retirement Plan (Tier IV) and replace it with a Defined Benefits Retirement Plan (Tier 111). The state will gain by having high quality state employees by doing so.

Respectfully yours,

Jimmy Yap

Environmental Engineering Assistant 1
Division of Air Quality, Department of Environmental Conservation
(907) 465-5123 Phone
(907) 465-5129 Fax
jimmy.yap@alaska.gov

Anna Sorensen

From: Smith, Patricia G (DFG) [patty.smith@alaska.gov]
Sent: Wednesday, February 25, 2009 8:12 AM
To: Sen. Joe Paskvan
Subject: SB23 Repeal of Defined Contributions

Senator Paskvan and Members of the Senate Labor and Commerce Committee:

Support for SB 23, which seeks to repeal the Defined Contribution Retirement Plan in place of a Defined Benefits Retirement Plan that guarantees new state employees with a pension at retirement. The move to a Defined Contribution Retirement Plan in 2006 was an experiment that failed, and it contributes significantly to our difficulties with recruitment and retention of employees. I ask that you right this wrong by supporting SB 23 and moving it out of committee when you meet on Thursday, 26 February.

Thanks,

Patty Smith

Dept of Fish and Game
Division of Habitat

Anna Sorensen

From: pupsickle@gmail.com on behalf of Erin [erinstrang@gmail.com]
Sent: Wednesday, February 25, 2009 8:10 AM
To: Sen. Joe Paskvan
Subject: Repeal of Tier IV
Follow Up Flag: Follow up
Flag Status: Red

Senator Paskvan,

I am thrilled to hear that the Senate is planning to address the inequalities of Alaska's tiered employee retirements and benefits plans. I am a Tier IV employee. I love my job and like working for the State, but the sad fact is that I can only afford to do so while I'm young. I fully expect to have to leave this position and return to the private sector within the next 5 years in order to be able to afford retirement. I would love to stay with the State until I retire, but without a defined benefit structure, it just is not a responsible decision. I have to think about my family, and leaving the burden of providing for our retirement almost entirely to my husband is not fair.

It meant a lot to myself and my husband that you stopped by our house and talked to us this fall to learn about our concerns and hopes for your time in Juneau. That you have been able to raise the Tier IV issue so quickly is incredibly heartening to me. Thank you for taking the time to listen to our concerns, and for following up on them so early in your time in office.

Sincerely,

Erin Strang

Erin Strang (erin.strang@alaska.gov)
Alaska Department of Environmental Conservation
Water Quality Standards
(907) 451-2881

Erin Strang (erinstrang@gmail.com)
702 Bentley Drive
Fairbanks, AK 99701
(907) 457-7179

3/13/2009

Anna Sorensen

From: Heinl, Steve (DFG) [steve.heinl@alaska.gov]
Sent: Wednesday, February 25, 2009 8:05 AM
To: Sen. Joe Paskvan
Subject: Senate Bill 23

Senator Paskvan –

I work for ADF&G as a Fishery Biologist in Ketchikan. I am contacting you in support of Senate Bill 23, which seeks to repeal the Defined Contribution Retirement Plan (Tier IV) and replace it with a Defined Benefits Retirement Plan (Tier III) that guarantees a pension for state employees at retirement. We have found it increasingly difficult to attract qualified candidates for positions within our department, seasonal positions and full-time biologist positions, and I believe the Tier IV retirement plan is part of the problem. Moving back to Tier III and a guaranteed pension will be a positive step in recruiting and retaining qualified people to work for the state of Alaska.

Thank you for your consideration, and I hope that you will support Senate Bill 23.

Steve Heinl

3/13/2009

Anna Sorensen

From: Naves, Liliana C (DFG) [liliana.naves@alaska.gov]
Sent: Wednesday, February 25, 2009 8:04 AM
To: Sen. Hollis French; Sen. Bill Wielechowski; Sen. Bettye Davis; Sen. Johnny Ellis; Sen. Lesil McGuire; Sen. Kevin Meyer; Sen. Con Bunde; Sen. Joe Paskvan; Sen. Joe Thomas; Sen. Kim Elton; Sen. Bill Wielechowski; Sen. Bill Wielechowski; Sen. Linda Menard
Subject: SB23 Repeal of Defined Contributions Retirement Plan (Tier IV)

Senators and Members of the Senate Labor and Commerce Committee:

I am writing you today to ask you to support SB23, which seeks to repeal the Defined Contribution Retirement Plan (Tier IV) in place of a Defined Benefits Retirement Plan (Tier III) that guarantees state employees with a pension at retirement. I am a State of Alaska employee hired under Tier IV. I am a highly qualified professional with a PhD degree. The Defined Contribution Retirement Plan provides little incentive for me and my coworkers to continue as a State public employee. I have seen extremely high turnover rate in Divisions of our Department including mine and it becomes difficult to fill a number of positions. There is no doubt that this pattern compromises the quality of the services provided by the State. I ask you to support the quality and long term sustainability of the State workforce by supporting SB23 when you meet on Thursday, February 26th.

Thank you,

Liliana Naves

Liliana C Naves
Research Analyst
Alaska Department of Fish & Game
Division of Subsistence
333 Raspberry Rd
Anchorage, AK 99518
phone: (907) 267-2302
fax: (907) 267-2450
liliana.naves@alaska.gov

Anna Sorensen

From: Hammock, Rolly (HSS) [rolly.hammock@alaska.gov]

Sent: Wednesday, February 25, 2009 7:22 AM

To: Sen. Joe Paskvan

Subject: Senate Bill 23

My name is Rollanda Hammock and I'm a tier 4 employee, I am concerned about my retirement as well are others that I work with. I would like you help pass Senate Bill 23. It will help keep good employee's. Thank you for your time. Rollanda Hammock

Anna Sorensen

From: Molyneaux, Doug B (DFG) [doug.molyneaux@alaska.gov]
Sent: Wednesday, February 25, 2009 5:29 AM
To: Sen. Joe Paskvan; Sen. Joe Thomas; Sen. Bettye Davis; Sen. Kevin Meyer; Sen. Con Bunde
Cc: Sen. Kim Elton; Sen. Johnny Ellis; Sen. Hollis French; Sen. Bill Wielechowski; Sen. Linda Menard; Sen. Lesil McGuire; Senator_Bill_Thomas@legis.state.ak.us
Subject: SB23 Repeal of Defined Contributions
Attachments: SB 23 Molyneaux 2009 PERS Testimony.doc

Senator Paskvan and Members of the Senate Labor and Commerce Committee:

Thank you for the opportunity last week to provide testimony in support of SB 23, which seeks to repeal the Defined Contribution Retirement Plan in place of a Defined Benefits Retirement Plan that guarantees new state employees with a pension at retirement. The move to a Defined Contribution Retirement Plan in 2006 was an experiment that failed, and it contributes significantly to our difficulties with recruitment and retention of employees. I ask that you right this wrong by supporting SB 23 and moving it out of committee when you meet on Thursday, 26 February. Attached is a copy of my testimony from last week.

Sincerely,

Douglas B. Molyneaux

Fishery Biologist
Commercial Fisheries Division, Kuskokwim Area
Alaska Dept. of Fish and Game

Winter (Anchorage):
333 Raspberry Road
Anchorage, AK 99518
Phone: 907-267-2397

Summer (Bethel):
P.O. box 1467
Bethel, AK 99559
(907) 543-2792

Anna Sorensen

From: Barb george [lady_loon@hotmail.com]
Sent: Tuesday, February 17, 2009 12:04 PM
To: Sen. Joe Paskvan; Sen. Joe Thomas
Subject: FW: Thanks

Good Morning! Thank you for signing on to co-sponsor one of the bills for returning to a defined benefit. As a newly retired teacher we need this bill to secure our retirement. We also need the bill to encourage our young teachers to remain in Alaska. We need their youth, energy and technology savvy in our schools. Thank you again, and keep up the good work.
Barb George, Fairbanks

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Anna Sorensen

From: Mary C Sullivan [anmcs1@uaa.alaska.edu]
Sent: Thursday, February 12, 2009 8:59 AM
To: Sen. Joe Paskvan; Sen. Joe Thomas; Sen. Bettye Davis
Subject: Defined Benefit; SB 23

Dear Senators,

I just wanted to write and thank you for your support of SB 23 to return to a defined benefit retirement for public employees. I hope that you will continue to support this initiative. In the following link you will find a memo from Senator Kim Elton to the Finance Committee summarizing findings by Buck Consultants from April 2007 regarding PRS and TRS employees and retirement systems. I hope you take time to read it and share it. Thank you. <http://acpp.info/2007/04/28/new-findings-regarding-public-employees-retirement-policies/>

Mary C. Sullivan

University of Alaska, Anchorage
anmcs1@uaa.alaska.edu
(907) 727-8773 (cell)

Anna Sorensen

From: Gary Miller [gmiller_juneauak@hotmail.com]
Sent: Monday, February 16, 2009 11:17 AM
To: Sen. Joe Paskvan; Sen. Joe Thomas; Sen. Bettye Davis; Sen. Kevin Meyer; Sen. Con Bunde
Subject: SB23

I support Senate bill 23, "An Act repealing the defined contribution retirement plans for teachers and for public employees; providing a defined benefit retirement plan for teachers and public employees; making conforming amendments; and providing for an effective date."

I am a tier I retiree with over 28 years of public service. My retirement plan included the three legged stool, with my three legs being my PERS retirement, my state SBS (Supplemental Benefits System) and Social Security. I currently live only on my PERS retirement.

Last year my SBS fund dropped \$61,000 so I can't afford to draw from it.

I am 60 years old so I don't qualify for Social Security yet. When I do qualify, my Social Security will be reduced because of the GPO (Government Pension Offset). People who paid in the same amount as I did will receive their full Social Security if they don't have a government pension, but I won't.

PERS should give retirees who dedicate their lives to public service a secure retirement. It should give them health care that does not run out and put them on welfare or Medicaid. It should let them live with dignity until they die.

I am currently sitting on a one-legged stool. I hope to stay in Alaska until I die. Defined Contribution tier retirees will find it more difficult to stay here when they retire. They won't have a secure retirement or health care. You can help them by passing SB 23.

Thank you.

Gary Miller
20135 Cohen Dr
Juneau, AK 99801-8211
789-3757
gmiller_juneauak@hotmail.com

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Anna Sorensen

From: Trisha.Allen@neaalaska.org
Sent: Thursday, March 05, 2009 10:00 AM
To: Rep. Bob Buch; Rep. Sharon Cissna; Rep. Harry Crawford; Rep. Nancy Dahlstrom; Sen. Bettye Davis; Rep. Bryce Edgmon; Sen. Johnny Ellis; Sen. Kim Elton; Sen. Hollis French; Rep. Les Gara; Rep. Max Gruenberg; Rep. John Harris; Rep. Mike Hawker; Rep. Bob Herron; Rep. Lindsey Holmes; Rep. Scott Kawasaki; Rep. Beth Kerttula; Rep. Bob Lynn; Sen. Lesil McGuire; Sen. Linda Menard; Rep. Cathy Munoz; Sen. Joe Paskvan; Rep. Pete Petersen; Sen. Joe Thomas; Rep. Chris Tuck; senator_bill_wielechowski@legis.state.as.us
Subject: Defined Benefit Pension System Co-Sponsors
Importance: High
Attachments: Ketchikan flyer.pdf; Sitka flyer.pdf

Dear Legislative Sponsor of returning to a defined benefit pension system:

Thank you for your sponsorship of legislation to return Alaska's public employees to a defined benefit pension system. The Alaska Public Pension Coalition will be hosting retirement security forums in Sitka (March 21) and Ketchikan (March 28) later this month. These are in addition to the forums that were sponsored in Bethel, Palmer, Fairbanks, Soldotna and Anchorage in December and January.

NEA-Alaska, as a founding member of the Alaska Public Pension Coalition, is leading the fight to restore a defined benefit retirement plan for Alaska's teachers, fire fighters, correctional and police officers, and public employees. For information about the coalition, pension reform, research, FAQ's, and legislative updates, visit www.akpensionreform.org

If you have any questions, please give me a call.

John Alcantra
 GR Director
 NEA-Alaska
 907-263-8547 (direct in Anchorage)
 907-354-3765 (cell)

Trisha Allen
 NEA-Alaska
 4100 Spenard Rd
 Anchorage, AK 99517
 Ph 907-274-0536
 Fax 907-274-0551
 trisha.allen@neaalaska.org

Anna Sorensen

From: Sam Harbo [sjharbo@yahoo.com]
Sent: Saturday, February 21, 2009 8:32 AM
To: Pat Abney; Alton; Charlie Arteaga; Bonnie Barber; Kate Caciari; Steve Click; karen eddy; Larry Ehnert; Margret Van Flein; tamie fogle; Charles Gallagher; Robyn Gonzales; Don Gray; Judith A DOR Hall; Jennifer Harbo; sam harbo; Hank Harrison; Dick and Betty Hertz; Sara Hornsberger; Jesse Kiehl; Kendra Kloster; Tamiah Liebersbach; Tamiah Liebersbach; Penny Marksheffel; Marilyn Marsh; rod McCoy; Freda Miller; cathy munoz; NANCY Nichols; Don Oberg; siobhan ohara; Sen. Joe Paskvan; Jerry Patterson; Bette Reed; barbara rich; Robb Salo; Scott & Cheryl Sauter; Donald P. Schulz; Barbara Stek; Susan A Stitham; Sen. Joe Thomas; Judith M Tolbert; Kristina Ingrid Tornqvist; sam trivette; Carolyn Tuovinen; Carolyn Tuovinen; Carol Waters; bob Wells
Subject: Fw: Read Across America March '09 Newsletter

Hi - For those of you who participate at your local schools, preschools or libraries, you may be able to use this info for your children, grandchildren or friends. Cheers. Gayle Harbo

--- On Fri, 2/20/09, NEA's Read Across America <readacross@nea.org> wrote:

From: NEA's Read Across America <readacross@nea.org>
 Subject: Read Across America March '09 Newsletter
 To: SJHARBO@YAHOO.COM
 Date: Friday, February 20, 2009, 3:56 PM

**In this Issue**

- New Downloadables from NEA's Read Across America
 - Free Seuss Books on kidthing
 - Oh, the Places You'll Go to Find NEA's Read Across America
 - Your Seuss Store and So Much More
 - Looking for Lesson Plans?
 - On Beyond Seuss
 - Download the Dear Mr. President book free from kidthing and share with your classroom
 - For Struggling Teens, a Second Chance
 - Bookshare
- RAA Tip of the Month
 Looking for celebrity readers? How about your local home town heroes? Firefighters, police chiefs, local authors, and even chefs make great read-aloud partners for your event. Make sure they're welcomed with banners, reading hats, and escorts

Celebrate NEA's Read Across America in True Seussian Style

March 2, NEA's Read Across America Day is fast approaching, and NEA and its Read Across America partners are ready with resources to make your celebration and your program Seussational.

New Downloadables from NEA's Read Across America

On the Read Across America website, www.nea.org/readacross, you'll find new certificates, proclamations, bookmarks, and media tools. The site will soon feature new celebrity posters and trading cards featuring Selena Gomez, Kyla Pratt, Alek Wek, Drake Bell, and more.

Free Seuss Books on kidthing

From Dr. Seuss and RAA partner kidthing, a collection of four classic Dr. Seuss titles FREE for your classroom throughout the month of March! Visit www.kidthing.com/nea and download digital read-along versions of *The Cat in the Hat*, *Horton Hears a Who!*, *Hop on Pop* and *Green Eggs and Ham!* for a student reading Seussational! Read along with the narrated soundtrack, or turn off the narration, and let kids read out loud to themselves.

Plus, print out personalized NEA's Read Across America "Certificates of Achievement" for all your students. There's even a free learning game for kids to celebrate their participation.

kidthing is the first and only free digital media player made just for kids and classrooms. Created by parents, kidthing

A Message From NEA President

Dennis Van Roekel
 "When it comes to NEA's Read Across America, the numbers speak louder than words. Where else can you find a program that mobilizes 45 million children and adults on a single day of reading and generates more than a million visits to the Read Across America web site and keeps reading on the radar 365 days a year?"
 Calendar

March
 Reading Month
March 2
NEA's Read Across America Day
www.nea.org/readacross
March 2-6
Newspapers in Education Week
www.naafoundation.org

April
April 22
Lorax Student Earth Day

to your library, gym, or classroom. Don't forget to send a thank you card after the event. For more tips, go to www.nea.org/readacross

provides a safe haven for kids to play and learn on the computer - away from Web browsers and ads. The kidthing store is filled with a wide variety of fun and engaging products including digital animated books, interactive games, activities, and videos from some of the world's leading brands. Kidthing is available on Windows XP and Windows Vista.

Oh, the Places You'll Go to Find NEA's Read Across America

NEA's Read Across America is now on Facebook. We've launched the cause page and fan pages to share our resources, links, and tools from Read Across America and its partners. Go to <https://causes.com/readacrossamerica> NEA's Read Across America is also featured on the Gateway to 21st Century Skills GEM site. Go to www.thegateway.org to see how we're featured.

Your Seuss Store and So Much More

If you're looking for Cat in the Hat hats, pins, pencil sets, t-shirts or even Cat suits, don't forget to check out the Seuss store at the NEA Professional Library. Go to www.nea.org/readacross and click on the RAA catalog.

Looking for Lesson Plans?

Check out Read/Write/Think.org, a collaborative effort between the National Council of Teachers of English, the International Reading Association, and Thinkfinity. You'll find lesson plans for NEA's Read Across America and ideas for literary celebrations of your own.

On Beyond Seuss

Remember, Read Across America is Seuss and so much more. If you'd like to go beyond Seuss, check out the Read Across America pledges and look for additional ideas to celebrate reading. You'll find tips for teens, character parades, reading challenges and favorite author studies. Go to www.nea.org/readacross and check out the pledges. Don't forget to share your own plans for celebrating the day.

More News from RAA Partners

Download the Dear Mr. President book free from kidthing and share with your classroom!

Kidthing and NEA proudly present *Dear Mr. President*, an incredible social narrative written and drawn by our youngest citizens. From across the nation and around the globe, from the heartfelt to the humorous, children share their amazing awareness and understanding of the complex issues in our lives today.

"My dream is to make the war stop" Lonnie, Japan, age 9

"Maybe we can find a way to use garbage to power things"

Zach, Michigan, age 10

"You are now a hero to me, someone I can look up to

when I'm out of hope" Charobeta, Missouri, age 12

"Please make it rain candy" Aaron, California, age 6

Share this inspiring snapshot of hope, wishes and advice for President Obama with your students, in this first-ever digital book of its kind! (A limited-edition print will also be sent to the White House!).

kidthing is the first and only free digital media player made just for kids and classrooms. Created by parents, kidthing provides a safe haven for kids to play and learn on the computer - away from web browsers and ads. The kidthing store is filled with a wide variety of fun and engaging products including digital animated books, interactive games, activities, and videos from some of the world's leading brands.

kidthing is available on Windows XP and Windows Vista.

Get your free Dear Mr. President digital book at

<http://www.kidthing.com/DMP>.

For Struggling Teens, a Second Chance

Award-winning author Walter Dean Myers has a new young adult book coming out February 10 called *Dope Sick* (HarperCollins, 2009). In writing this tale of second chances, redemption, and hope, his goal is to reach teens who need to

www.nea.org/readacross

www.theloraxproject.com

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Days**

www.yasa.org

make positive life changes. In tandem with the book's publication, Myers and AdLit.org have joined forces to create The Second Chance Initiative-an effort to motivate teens to overcome life's challenges, move beyond mistakes of the past, and make better choices in the future. The initiative includes materials for students, teachers, and parents. You can also read the first three chapters of *Dope Sick* for free! Go to www.adlit.org. You'll find podcasts and audiocasts of Myers himself, plus lesson plans, and resources.

Bookshare

Bookshare (www.bookshare.org) is the world's largest accessible digital library for persons with print and learning disabilities (such as dyslexia). Students with qualifying disabilities get FREE access to over 43,000 digital books, textbooks and teacher recommended reading, as well as assistive reading technology to help them read and study independently. Membership for students and schools is free thanks to an award from the U.S. Department of Education's Office of Special Education (OSEP). Parents and teachers can sign up their children by going to registration (<http://www.bookshare.org/signUpType>).

Looking for Books?

First Book provides new books to children in need, addressing one of the most important factors affecting literacy - access to books. An innovative leader in social enterprise, First Book has distributed more than 65 million free and low cost books to disadvantaged children and the programs that serve them since 1992. NEA members serving children in need that register with First Book can access new books for free or at deeply discounted prices from three separate First Book programs:

- The First Book Marketplace is an online store that sells books and educational materials to registered First Book programs that serve at least 50% children from low-income families for up to 90% off retail prices.
- The First Book National Book Bank distributes millions of free books donated by leading publishing houses to programs that serve at least 80% children from low-income families.
- First Book Advisory Boards grants free books to local programs that serve at least 80% children from low-income families in 270 communities nationwide.

The First Book Marketplace is an online store offering nearly 1,500 children's book titles up to 85% off retail prices. That's an average price of \$1.85 per book! Are you looking to get *The Very Hungry Caterpillar*, *Click, Clack, Moo, Goodnight Moon*, *Beverly Cleary* or other great titles for your classroom for less than \$3.00? Take action and connect your program to First Book. Step 1: Register your program at www.firstbook.org/register. Step 2: Go to www.fbmarketplace.org to check out all of the amazing titles and purchase brand new books for all the children you serve.

Anna Sorensen

From: gregnkel [gregnkel@alaska.net]
Sent: Tuesday, February 10, 2009 4:30 PM
To: Sen. Joe Paskvan
Subject: SB 23

Dear Senator Paskvan,

I am writing in regard to SB 23. As an educator in my 12th year in the Anchorage School District I have been and remain very concerned about the changes that have been made in TRS over the last few years. As I'm sure you're aware, the new Tier has not met expectations and I believe will end up costing the State far more in the future. The change from a Defined Benefit plan has cost the state new long term employees. New hires are harder and harder to find, primarily because they see no reason to stay. While annual pay may be competitive in some areas for new hires, the retirement package does not provide an incentive to stay. As a result we have people coming and leaving after a year or two. Worse, there are far too many stories of new hires signing contracts in the Spring and not showing up in the fall once they realize with the Defined Contribution actually means. One example of the effect of the Defined Contribution is here in Anchorage where in 25% of the people teaching in Special Education are not certificated Special Educators. This then requires the ASD to spend money to train and retrain them. As well, many positions are going unfilled.

The other failure of the Defined Contribution is in saving the state money. Not only does this new plan not save money it will eventually cost the State more money. As a Tier 2 member, I am planning on retiring here in Alaska. I also plan on living a long time. Now with Tier 3, there is no one back-filling TRS for me, as I am doing for those who've gone before me. So Alaska is now in a situation where the State will be responsible for every Tier 1 and 2 member and their spouse until they day they die. This of course was short-sighted as we ended a semi-self funded retirement plan for one the costs us in the short term by not being able to retain new hires, and in the long term as the State will be required to pick up the costs of every Tier 1 and 2 member's retirement and health costs. Its unlikely that the citizens of Alaska will be overly excited about this prospect.

My final comment is that around the country states that have previously done away with have now reversed themselves and reinstated the Defined Benefit plan. Alaska should not waste time and more money waiting to eventually do the same thing.

Thank you for your time,

Greg Hartlieb

Anna Sorensen

From: Glen Ramos [Glen.Ramos@matsuk12.us]
Sent: Wednesday, February 11, 2009 3:45 PM
To: Sen. Joe Paskvan
Subject: SB 23

Dear Senator,
Thank you for your continued support for education and co-sponsoring the Return to a Defined Benefit Program.
Respectfully,
Glen Ramos, NEA Director-Palmer

Anna Sorensen

From: comoxjd@gci.net on behalf of judith anderegg [comoxjd@gci.net]
Sent: Saturday, February 07, 2009 7:49 AM
To: Sen. Joe Paskvan; Sen. Bettye Davis; Sen. Kevin Meyer; Sen. Joe Thomas; Sen. Con Bunde
Subject: Fwd: SB23 - defined benefits retirement plan

Dear Senators,

It has just come to our attention that SB23 was written not just for teachers but all public employees. So much the better - we feel that all employees in the public sector give of themselves for the public good.

Please re-establish a plan for that allows all public employees to retire with dignity after years of service to the state of Alaska and its residents. Thank you for this time to comment.

Sincerely,
Judith Anderegg and David Pelto
po box 1472
palmer, alaska 99645

Begin forwarded message:

From: judith anderegg <comoxjd@gci.net>
Date: February 7, 2009 7:25:36 AM AKST
To: Senator_Joe_Paskvan@legis.state.ak.us
Subject: SB23 - defined benefits retirement plan

Please support the reinstatement of a defined benefits retirement plan for teachers - as laid out in SB23.

The current defined contributions plan does not provide the kind of retirement that teachers who have spent their entire adult lives educating young people deserve. The lack of a defined benefits retirement plan is detrimental to a stable teaching community. Without a defined benefits retirement plan to be a part of their compensation package, why should teachers (who often do not receive regular or substantial salary increases) commit themselves to a career teaching in Alaska? It also does not provide funding to support the original defined benefits plan and all the teachers who are entitled to receive benefits under its structure.

Further, as we have tried to help our new young friends just entering the teaching profession, we are appalled by the poorly structured and state-managed current "defined contributions" plan. The plan does not provide for any financial education for the participants nor does it provide adequate "no-load" options for investment. Put simply, the "defined contributions" plan can not possibly provide for an adequate retirement under its current design. Our teachers deserve better.

As teachers with lifetime careers in Alaska who retired under the "defined benefits" plan, we feel that the state recognized our value and contribution to our young people. During our career, we had our salaries frozen several times and never received the kind of salary increases of the private sector, but our retirement plan removed any anxiety over how we


would pay for our "golden years." It was a fair trade- we invested ourselves in the youth of the state while the state invested in us.

Further, we have learned from information from Dept. of Administration that the "defined benefits" money has come out way ahead of "defined contributions" money. The professional managed funds have outperformed the individual managed funds. It is clear that the state should return to the "defined benefits" plan for the benefit of all.

Sincerely,
Judith Anderegg and David Pelto

Alaska State Public Opinion Message System:

Sen Joe Paskvan's office

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Supporters There are 17 Supporters

Constituent/**Non-Constituent** **Saved/ Not**
Bruce Sollenberger of Anchorage **Saved**
 (23) wrote the following message On
 2/26/2009 at 13:41 In support of *SB 23 REPEAL*
DEFINED CONTRIB RETIREMENT PLANS

Message:

The defined benefit system does not allow for retaining qualified teachers and public officials because they need a longterm retirement system which is not to be found under the existing system.

Message was delivered by Pom

[View Case](#) [Delete case](#)

Contact Info:

Bruce Sollenberger
 1811 Talkeetna St
 Anchorage AK, 99508-3246

Constituent/**Non-Constituent** **Saved/ Not**
Winnifred Sollenberger of **Saved**
 Anchorage (23) wrote the following message
 On 2/26/2009 at 16:07 In support of *SB 23*
REPEAL DEFINED CONTRIB
RETIREMENT PLANS

Message:

Please return to a defined benefit retirement program in order to recruit the best qualified teachers and state employees.

Message was delivered by Pom

[View Case](#) [Delete case](#)

Contact Info:

Winnifred Sollenberger

Messages

Constituent/**Non-Constituent** **Saved/ Not**
Constance Boquist of Anchorage **Saved**
 (30) wrote the following message On
 2/26/2009 at 08:41 about *SB 23 REPEAL*
DEFINED CONTRIB RETIREMENT PLANS

Message:

State employees deserve the security of a guaranteed pension and health insurance in retirement." "The Tier IV retirement plan does not ensure an adequate and predictable retirement." "State services suffer when inadequate benefits cause quality employees to seek work elsewhere." "Please SUPPORT SB 23

Message was delivered by Pom

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Contact Info:

Constance Boquist
 2723 Snug Harbor Cir
 Anchorage AK, 99507-4909
Work:9072697843
Home:9073381232
Email:cboquist@gci.net

Constituent/**Non-Constituent** **Saved/ Not**
Constance Boquist of Anchorage **Saved**
 (30) wrote the following message On
 2/26/2009 at 08:41 about *SB 23 REPEAL*
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Message:

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1811 Talkeetna St
Anchorage AK, 99508-3246

Constituent/**Non-Constituent** **Saved/ Not**
Carrie Miller of Anchorage (28) Saved
wrote the following message On 2/25/2009 at
20:42 In support of *SB 23 REPEAL DEFINED*
CONTRIB RETIREMENT PLANS

Message:

State employees deserve the security of a guaranteed pension and health insurance in retirement. The Tier IV plan does not ensure an adequate and predictable retirement. State services suffer when inadeguate benefits cause quality employees to seek work elsewhere.

Message was delivered by Pom

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Contact Info:

Carrie Miller
11741 Ellen Ave
Anchorage AK, 99515-3386
Work:269-5088
Home:522-3024
Email:CARRIEBYMAIL@YAHOO.COM

Constituent/**Non-Constituent** **Saved/ Not**
Carrie Miller of Anchorage (28) Saved
wrote the following message On 2/25/2009 at
20:42 In support of *SB 23 REPEAL DEFINED*
CONTRIB RETIREMENT PLANS

Message:

State employees deserve the security of a guaranteed pension and health insurance in retirement. The Tier IV plan does not ensure an adequate and predictable retirement. State services suffer when inadeguate benefits cause quality employees to seek work elsewhere.

Message was delivered by Pom

[View Case](#) [Delete case](#)

Contact Info:

Carrie Miller
11741 Ellen Ave
Anchorage AK, 99515-3386
Work:269-5088
Home:522-3024

retirement." "State services suffer when inadequate benefits cause quality employees to seek work elsewhere." "Please SUPPORT SB 23

Message was delivered by Pom

[View Case](#) [Delete case](#)

Contact Info:

Constance Boquist
2723 Snug Harbor Cir
Anchorage AK, 99507-4909
Work:9072697843
Home:9073381232
Email:cboquist@gci.net

Constituent/**Non-Constituent** **Saved/ Not**
Constance Boquist of Anchorage Saved
(30) wrote the following message On
2/26/2009 at 08:41 about *SB 23 REPEAL*
DEFINED CONTRIB RETIREMENT PLANS

Message:

State employees deserve the security of a guaranteed pension and health insurance in retirement." "The Tier IV retirement plan does not ensure an adequate and predictable retirement." "State services suffer when inadequate benefits cause quality employees to seek work elsewhere." "Please SUPPORT SB 23

Message was delivered by Pom

[View Case](#) [Delete case](#)

Contact Info:

Constance Boquist
2723 Snug Harbor Cir
Anchorage AK, 99507-4909
Work:9072697843
Home:9073381232
Email:cboquist@gci.net

Email:CARRIEBYMAIL@YAHOO.COM

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Constituent/Non-Constituent **Saved/ Not**
Carrie Miller of Anchorage (28) Saved
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 20:42 In support of *SB 23 REPEAL DEFINED*
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Message:

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Message was delivered by Pom

[View Case](#) [Delete case](#)

Contact Info:

Carrie Miller
 11741 Ellen Ave
 Anchorage AK, 99515-3386

Work:269-5088

Home:522-3024

Email:CARRIEBYMAIL@YAHOO.COM

Constituent/Non-Constituent **Saved/ Not**
Sandra Milewski of Anchorage Saved
 (31) wrote the following message On
 2/4/2009 at 09:55 In support of *SB 23 REPEAL*
DEFINED CONTRIB RETIREMENT PLANS

Message:

Please co-sponsor SB 23, HB 30 and HB 54. These are of extreme importance to the teachers of Alaska. Thank you for your consideration. Sandra Milewski, retired teacher

Message was delivered by Pom

[View Case](#) [Delete case](#)

Contact Info:

Sandra Milewski
 3651 Furrow Creek Rd
 Anchorage AK, 99516-2874

Work:907-345-3427

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<u>Andrew Merrill</u> of Nome (39)	Saved

wrote the following message On 2/17/2009 at
18:59 In support of *SB 23 REPEAL DEFINED
CONTRIB RETIREMENT PLANS*

Message:

Thank you for sponsoring SB 23. As a public
Employee under Tier III this bill will correct
the mistake that was made several years ago
and will encourage/entice many talented and
needed individuals into State Service. This

will also ensure that the defined benefits system will be properly funded.

Message was delivered by Pom

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Contact Info:

Andrew Merrill
Po Box 1952
Nome AK, 99762
Email:drewmerrill@hotmail.com

Constituent/ Non-Constituent	Saved/ Not
<u>Andrew Merrill</u> of Nome (39)	Saved

wrote the following message On 2/17/2009 at 19:08 In support of *SB 23 REPEAL DEFINED CONTRIB RETIREMENT PLANS*

Message:

Please support SB 23. This bill ensures that qualified applicants will apply for State service. It gives future employees the same benefits that I and others enjoy for the sacrifices we make to serve the citizens of Alaska. We should never hear "I'm tier one, I got mine, who cares?"

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Message:

Please support SB 23. As a Tier III employee some think that it does not directly effect me. I strongly disagree. Where I work we are currently 2 people short. This bill will help entice solid qualified individuals into State service. Thank you.

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SB

23

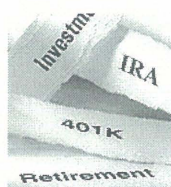
(FILE 2)

**Senate Bill 23:
Restore Defined Benefit
Research**

SB 23 RESTORE DEFINED BENEFIT RESEARCH

CONTENTS OF FILE:

- 1) "Pensionomics" and "A Better Bang for the Buck," testimony by Beth Almeida
- 2) State of Alaska, Actuarial Audit of TRS & PERS, October 24, 2002 by Mark O. Johnson
- 3) Legislative Audit Report 02-30037-06, December 30, 2005, Departments of Administration and Revenue Public Employees' Retirement System, Teachers Retirement System, and Alaska State Pension Investment Board: Selected Issues
- 4) Alaska Retirement Management Board et al. v. Mercer (US) Inc. et al, Case No. 1JU-07-974
- 5) "Public Employees' Retirement System, Teachers' Retirement System," presentation to House Finance Committee on PERS/TRS 2009
- 6) Pension Research Council, 2009 Newsletter
- 7) "The New Intersection on the Road to Retirement: Public Pensions, Economics, Perceptions, Politics, and Interest Groups," by Almeida, Kenneally & Madland, September 2008
- 8) "Better Bang for the Buck: The Economic Efficiencies of Defines Benefit Pension Plans," by Beth Almeida & William Forna, August 2008
- 9) "Reinventing the Retirement Paradigm," ed. By Robert L. Clark & Olivia S. Mitchell, Oxford Univ. Press, 2005
- 10) "The Pension Factor: Assessing the Role of Defined Benefit Plans in Reducing Elder Hardships," by Frank Porell & Beth Almeida, July 2009 (article and Power Point slides)
- 11) Notes from testimony of Michael Lamb, CFO of Fairbanks Northstar Borough, before the Senate Labor & Commerce Committee, February 12, 2009. (See also the minutes for this meeting on BASIS.)



Extra 5/27/2009 12:01 AM ET

America's looming retirement crisis

Insufficient savings is just part of the problem, experts say. When traditional pensions were jettisoned, so was the assurance that money would last until death.

[Related content: [401k](#), [retirement planning](#), [mutual funds](#), [investing strategy](#), [retirement savings](#)]

By [The Big Money](#)

"Our nation's system of retirement security is imperiled, headed for a serious train wreck. That wreck is not merely waiting to happen; we are running on a dangerous track that is leading directly to a serious crash that will disable major parts of our retirement system."

-- John Bogle, Feb. 24, 2009

If, several years before the financial and credit crisis hit, someone had told you that the housing market was preposterously overvalued and derivatives were headed for cataclysm, would it have been worth paying attention to? The answer's pretty clearly yes, ain't it? Of course, some of the best minds in finance -- from Warren Buffett to Yale housing economist Robert Shiller -- did. It's just that hardly anyone listened.

Now there's another crisis building. It's just as big. Again, some of the best thinkers in the financial world are warning about it. (Yes, Buffett's one of them.) And yet again, as is often the case with gathering storms, most of us are doing our best to ignore the warning signs.

Americans lost almost one-quarter of their retirement savings last year. But even if there were no market drop, we'd still be facing a disaster.

Talk back: [Are you worried about your retirement?](#)

The urgent lines at the top of this story come from John Bogle, founder of the Vanguard group of mutual funds and father of the low-cost stock-index fund -- the simplest and most cost-efficient tool yet devised for individual investing in stocks. Of all the people who've thought longest and best about individual investing, Bogle has to rank near the top. For decades before the financial crisis ripped open the country's retirement accounts, Bogle was tirelessly warning people away from their brokers' fads and follies.

Bogle's voice is now one of the loudest and most cogent of those calling for a rethinking of American retirement. He made the remarks above to a congressional panel looking at the security of American savings. Like much of what is said about retirement, Bogle's words passed by without much attention. But much of what he has to say is seriously worth listening to.

Over the past two decades, we've embarked on what is essentially a novel experiment, replacing the pension plans of the past with a patchwork of individual accounts. We had sound reasons for this: Letting people choose how much they save for retirement instead of counting on their employers to give them a decent pension if they put in enough time makes sense. But if the basic idea of personal responsibility for retirement is appealing to most, the reality is a lot thornier.

By this point, there is hardly anyone left who hasn't heard of a 401k or doesn't know that they should open one. With some tweaks to the rules for 401k enrollment, the Obama administration is hoping to get participation in individual retirement plans up to 80% of Americans.

The bad news from Bogle, though, is that the way it's set up now, the 401k isn't the panacea that policymakers across the spectrum hope it will be. What's wrong with the 401k? Simply having a retirement account is not enough. Much of the discussion this past year has focused on getting more workers to open a 401k. The problem is that the big majority of retirement accounts don't really hold nearly enough money.

According to Bogle's numbers, the **median IRA has \$55,000 in it**. By his calculations, that's enough to provide a steady income of \$2,200 a year -- less than \$200 a month. That's *it*.

The typical 401k holds only \$15,000. Bogle argues that to reach the level of income they hope for in retirement, Americans need to put 15% of their earnings in retirement accounts for their entire working lives. Very few do.

Video on MSN Money



Mutual fund pioneer pushes overhaul

John Bogle, founder and former chief of the Vanguard Group, wants to help small investors understand risk and protect them from what he sees as overpaid financial middlemen. (April 15)

One of the biggest differences between individual accounts and traditional pension plans is that they transfer what Bogle calls "longevity risk" from pension funds to individuals. What that means in practice is that you need to save more -- a lot more -- in your account than a pension plan would include in order to cover the chance that you'll live to a very old age.

Right now, we have no good solution to this. In theory, you should be able to put your money into an annuity at retirement that'll cover this risk. But as Bogle points out, there are virtually no annuities that will let you do this at a low cost. So now your underfunded retirement account looks even worse.

Talk back: [Do you expect an inheritance?](#)

We all know the financial advice about putting retirement assets in safe investments as we grow older. But

in practice, we don't come close to following it. Most retirement fund assets are in equities. And it doesn't get much better for people approaching retirement: According to Bogle, 30% of them have 80% of their IRA investments in stocks.

What this means in practice is that some people (not many, Bogle thinks, as most people make terrible investment decisions) will do very well. And others, such as the people retiring this year in the wake of the massive stock market drop, will do very badly. It's what Bogle calls investment risk, and like longevity risk, moving from pension plans to individual instruments such as a 401k or an IRA has transferred that from corporations to retirees.

Facing a one-two punch

Bogle proposes the beginnings of several solutions to our retirement problem. Clearly, finding ways to nudge people to put more money into retirement accounts is part of the answer. But it's only a small part. It does nothing for longevity risk and nothing to distribute investment risk. Pension funds did that: If you happened to retire the year the market crashed or if you lived to be 90 years old, that was OK, because your risks were shared with people who retired in other years or failed to live as long.

As it stands now, 401k plans do nothing for those risks. On the contrary, many of the bad practices that Americans have fallen into, such as putting much of their retirement money in their own employer's stock, exacerbate them.

Bogle points to several tools -- the creation of annuities that would work a lot like pension plans to level investment and longevity risk -- that would help give Americans the equipment they need to manage their retirement. But developing those tools and making them widely available right now just aren't on the political agenda. And Bogle (who wryly urges casting the "money changers" of Wall Street out of "the temple of finance") warns that we shouldn't expect them to come from the big financial companies.

Do 401k plans still make sense?

We're already witnessing the beginnings of a retirement catastrophe now: You can see it if you look at the growing number of older Americans who have kept working into their 60s and 70s or gone back into the work force. Without a dramatic change not just in the amount of money that we save but in how we save, it will get much worse.

In the 1980s, Britain launched what turned out to be a disastrous experiment in asking people to take responsibility for their retirement investments without giving them the tools to do it. We're now well on our way to repeating it on a much bigger scale.

Without it, we're facing a one-two punch in the retirement future. The lead left is the shortage of savings. The ensuing right is the added investment and longevity risk that the new model of retirement brings. It's a potential disaster as big as the mortgage and credit crisis. And as with those, if we get to it, folks in finance will be out in force, crying that nobody could possibly have seen it coming. That's just not true.

This article was reported by Mark Gimein for The Big Money.

“Pensionomics” and “A Better Bang for the Buck”

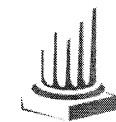
**Testimony of Beth Almeida
Executive Director
Senate State Affairs Committee
Legislature of the State of Alaska
March 24, 2009**



**NATIONAL INSTITUTE ON
Retirement Security**

NIRS Mission

- Contribute to informed policy making by fostering a deep understanding of the value of retirement security to employees, employers, and the economy as a whole.
- Research, education, and outreach programs that are national in scope.

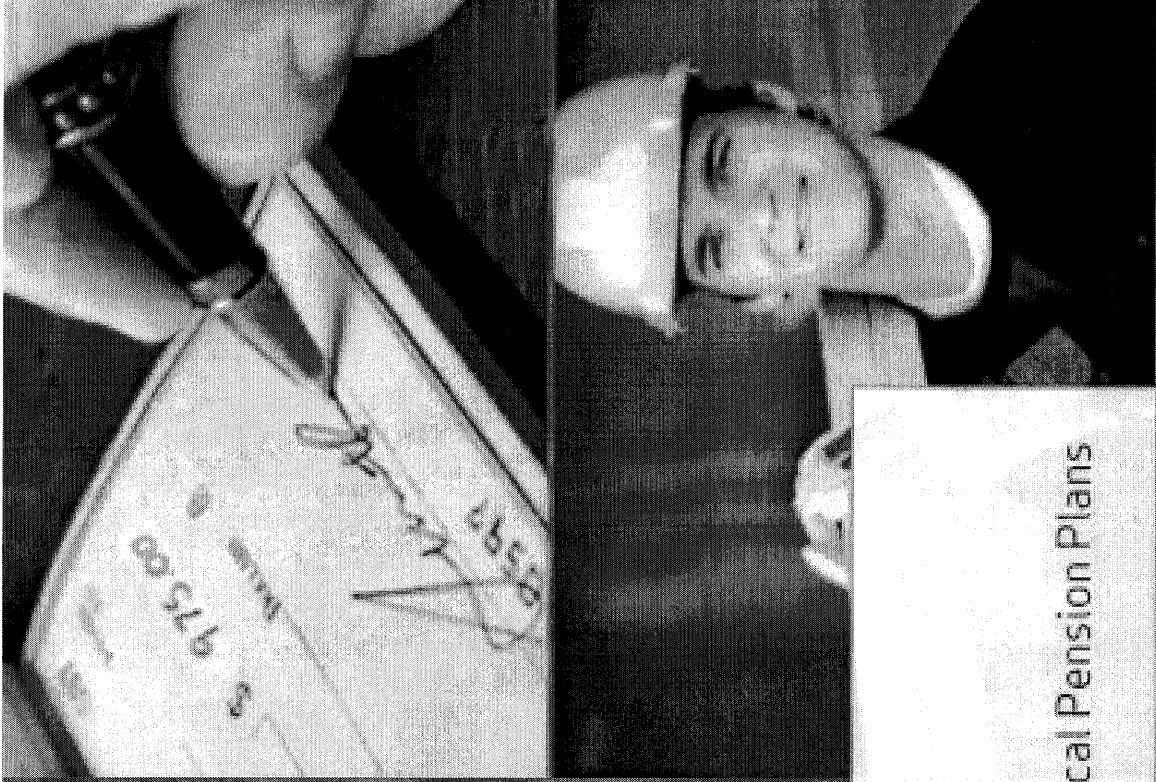
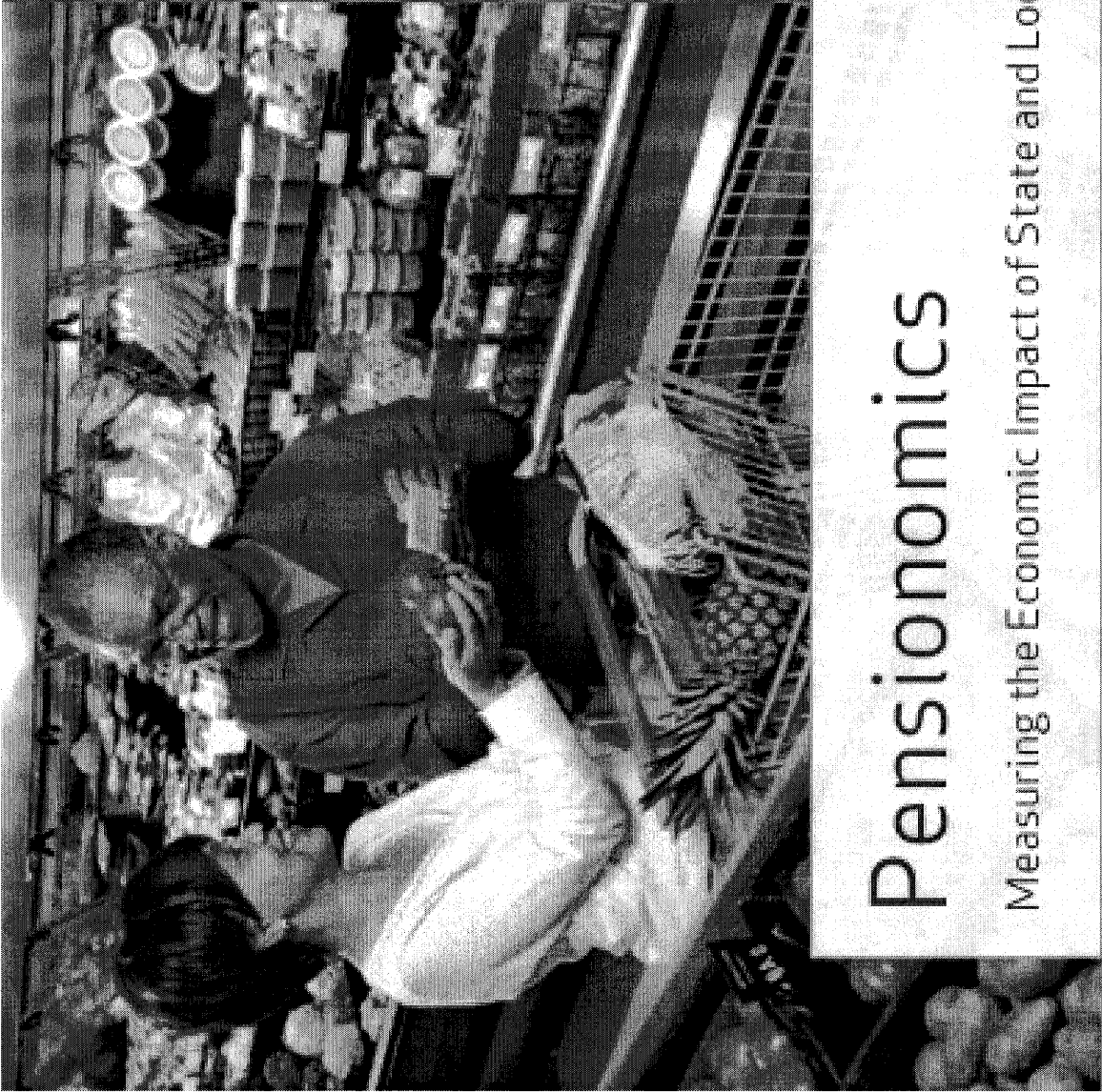


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NIRS Membership

- NIRS has a diverse membership of organizations interested in retirement security
- Members include:
 - Employee benefit plans
 - State/local agencies that manage retirement plans
 - Trade associations
 - Financial services firms
 - Other retirement providers





Pensionomics

Measuring the Economic Impact of State and Local Pension Plans

by Ilana Boivie and Beth Almeida

February 2009

Why We Did this Study

- Measure the “economic footprint” of state and local pension plans, both nationally and within states.
- DB plans act as an “automatic stabilizer” for the economy
 - Even in tough times, retirees with a reliable pension can maintain spending on basic needs
- Get a sense of how much of a stabilizing effect state and local pensions may have on the U.S. economy and state economies.



What We Found - Nationally

- In 2006, expenditures made out of state and local retirement benefits supported...
 - **2.5 million jobs** that paid **\$92 billion** in income
 - **\$358 billion** in economic output nationwide
 - **\$57 billion** in federal, state, and local tax revenue



What We Found - Alaska

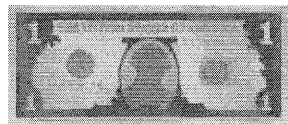
- In 2006, expenditures made out of state and local retirement benefits supported...
 - **6,270 jobs** that paid **\$385 million** in income
 - **\$1 billion** in economic output statewide
 - **\$155 million** in federal, state, and local tax revenue



What We Found - Alaska

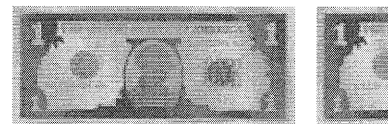
- For every dollar paid out in benefits, \$1.25 in total economic activity was supported in the state.

Pension Benefit Multiplier



\$1.00

pension benefits paid to
retirees in Alaska



\$1.25

total economic activity



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What We Found - Alaska

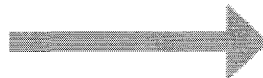
- For every dollar contributed by taxpayers, \$6.35 in economic activity was supported in the state.

Taxpayer Contribution Factor*



\$1.00

contributed by Alaska taxpayers
to state and local pensions



\$6.35

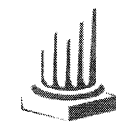
total economic activity



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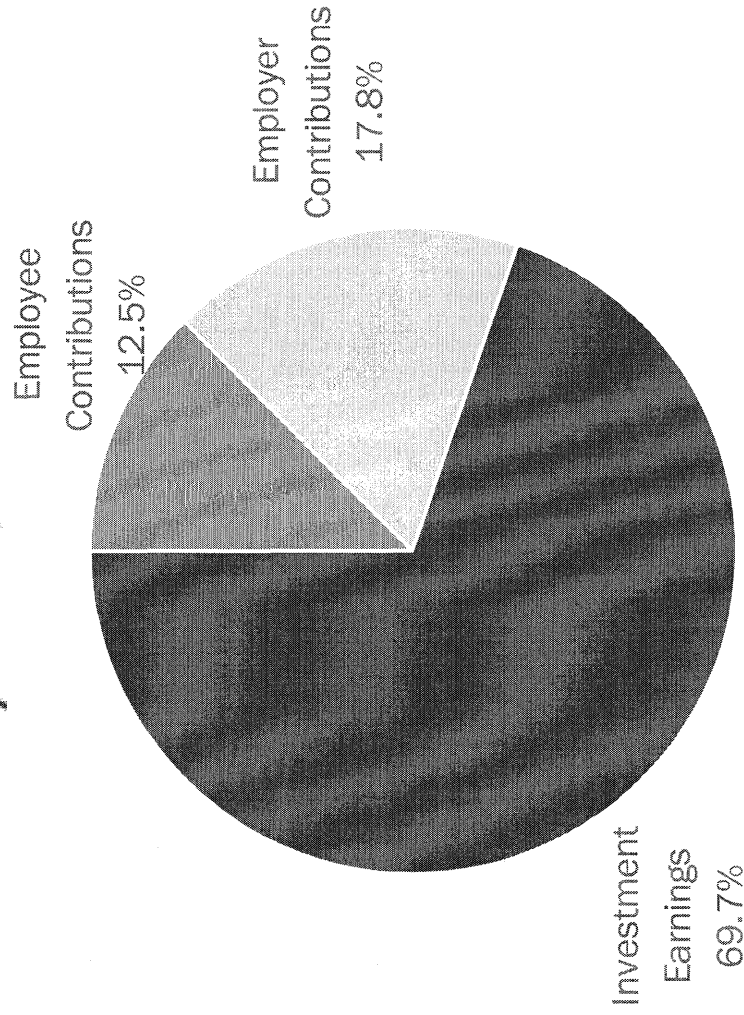
Overview of State and Local DB Pensions in Alaska

- According to the U.S. Census Bureau, close to 35,000 Alaskans received pension benefits from state and local pensions in 2006.
- Retired Alaskans received roughly \$819 million in benefit payments in 2006.
- The average pension was \$1,953 per month, or \$23,440 per year.



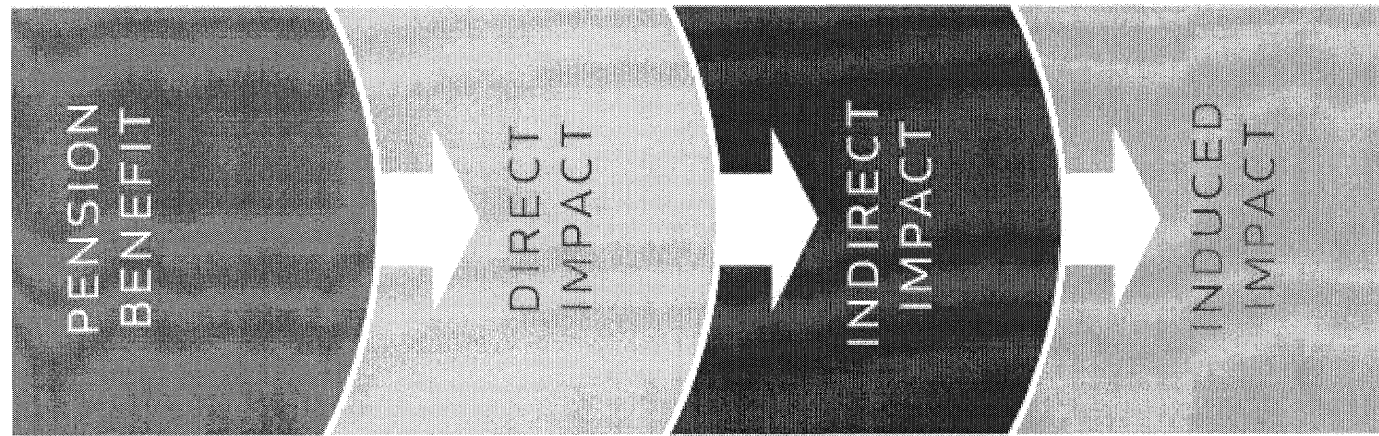
Financing of State and Local Pension Plans in Alaska

Aggregate Contributions by Source,
1993-2006



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Figure 2:
The Multiplier Effect: How Spending Ripples Through the Economy, Supporting Jobs and Incomes in the Process



A retired schoolteacher...

...uses her pension money to buy a car.

As a result of that purchase, the owner of the car dealership, the car salesman, and each of the companies involved in the production of the car all see an increase in income, and spend that additional income.

These companies hire additional employees as a result of this increased business, and those new employees spend their paychecks in the local economy.

Methodology

What We Did

- Began with benefit payment data from the U.S. Census Bureau's State & Local Government Employee Retirement System survey.
- Estimated taxes paid out of benefits using data from CBO and Edwards and Wallace (2004).
- Adjusted Census benefit payment data to account for migration of retirees from one state to another.
- Using IMPLAN input-output modeling software, estimated the economic impacts of retiree expenditures and taxes.

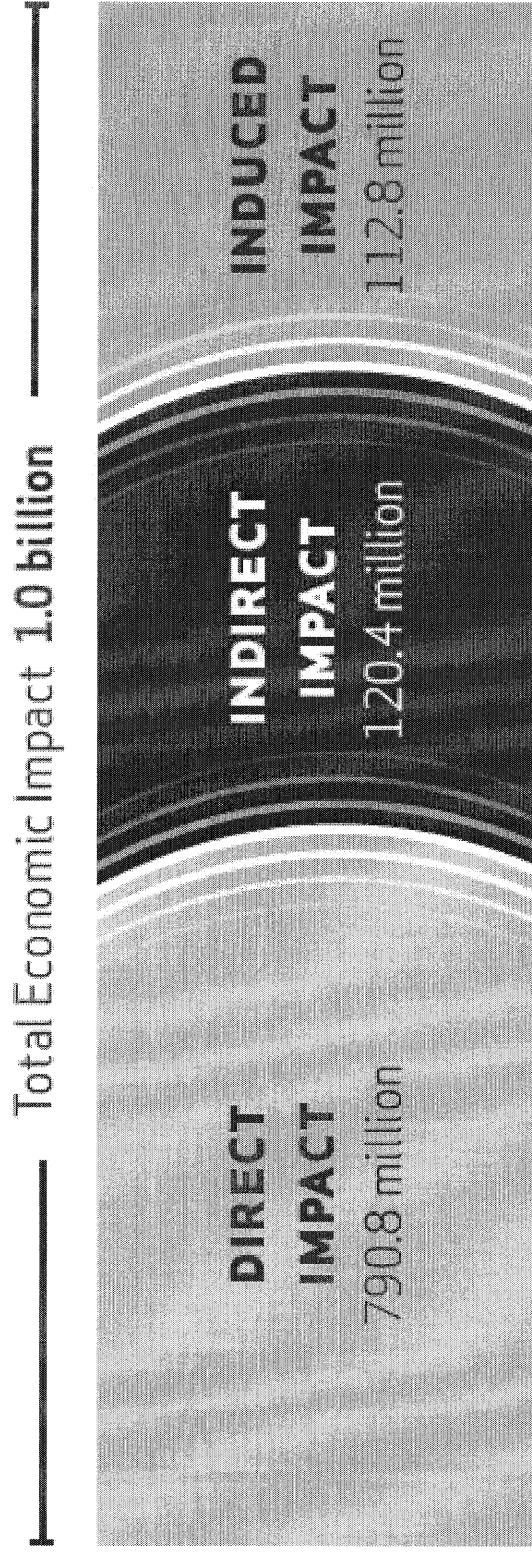


What is IMPLAN?

- IMPLAN is an input-output modeling software originally developed for a USDA Forest Service project, now used for many types of analysis.
- It represents relationships among various sectors in the economy as a matrix. It estimates how an initial event reverberates through the economy.
- IMPLAN was used to estimate the following economic impacts: jobs, incomes, value added, total output, and tax revenue.



Alaska Results: Total Economic Impact



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Alaska Results: Tax Revenue Impact

Federal Tax	87.5 million
State/Local Tax	67.8 million
Other Corporate Taxes	0.2 million
Total	\$155.5 million



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Alaska Results:

Economic Impacts by Industry

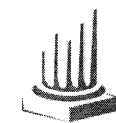
- Industries with most jobs supported
 - Health Care and Social Assistance: 1,354 jobs
 - Retail Trade: 1,331 jobs
 - Accommodation and Food Services: 839 jobs
- Industries where greatest economic impact felt
 - Health Care and Social Assistance: \$119 million
 - Retail Trade: \$97 million
 - Real Estate, Rental, Leasing: \$51 billion



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Alaska Results: Economic Impacts by Industry

Industry	Employment Impact (# Jobs)	Value Added Impact (\$ millions)	Income Impact (\$ millions)	Output Impact (\$ millions)
Health Care and Social Assistance	1,354	\$75.0	\$74.2	\$119.1
Retail Trade	1,331	64.4	50.9	97.0
Accommodation and Food Services	839	26.7	23.8	50.0
Other Services (Except Public Administration)	479	14.2	13.3	27.1
Real Estate and Rental and Leasing	452	33.8	28.2	50.8
Professional, Scientific, and Technical Services	229	11.8	11.5	23.2
Arts, Entertainment, and Recreation	229	6.2	5.6	10.8
Finance and Insurance	227	24.2	23.3	43.9
Public Administration	196	10.1	10.1	20.7
Transportation and Warehousing	187	11.4	10.8	22.0



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Alaska Results: Pension Expenditure Multiplier

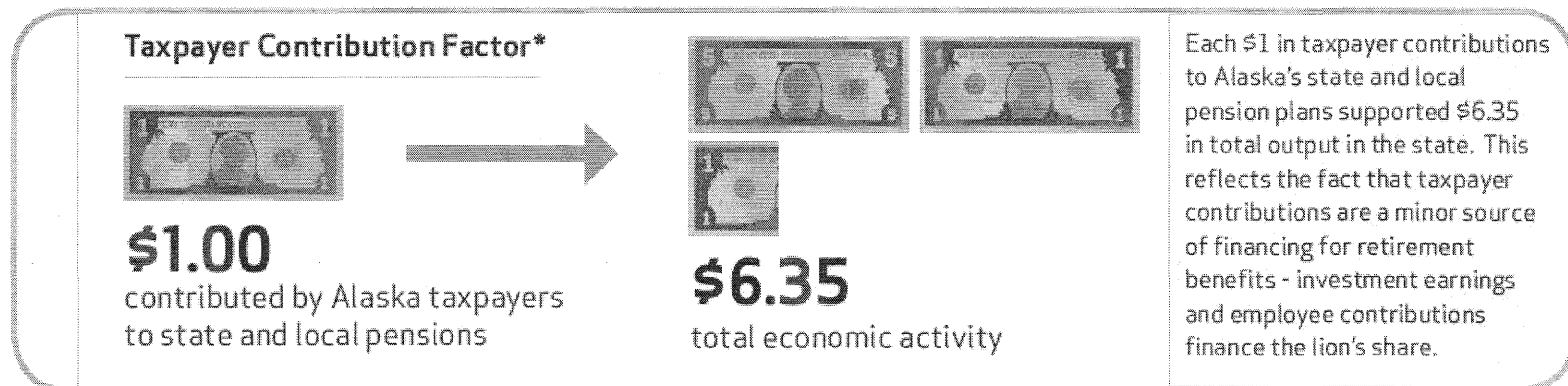
- What is the total economic impact of each dollar paid out in pension benefits?
- An expenditure multiplier measures the size of the “ripple effect” of retirees’ expenditures



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Alaska Results: Taxpayer Contribution Factor

- What is the “return” on each dollar taxpayers “invest” in state/local pension plans?
- Because employee contributions and investment earnings finance most of the benefits, this factor is large...



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Conclusions

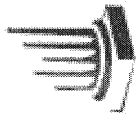
- State and local pension plans have a large economic footprint in the U.S. and Alaska.
- State and local pensions have significant ripple effects – one retiree’s spending becomes someone else’s income.
- State and local pensions have sizable multipliers – up-front investment of taxpayer dollar goes a long way.



Conclusions

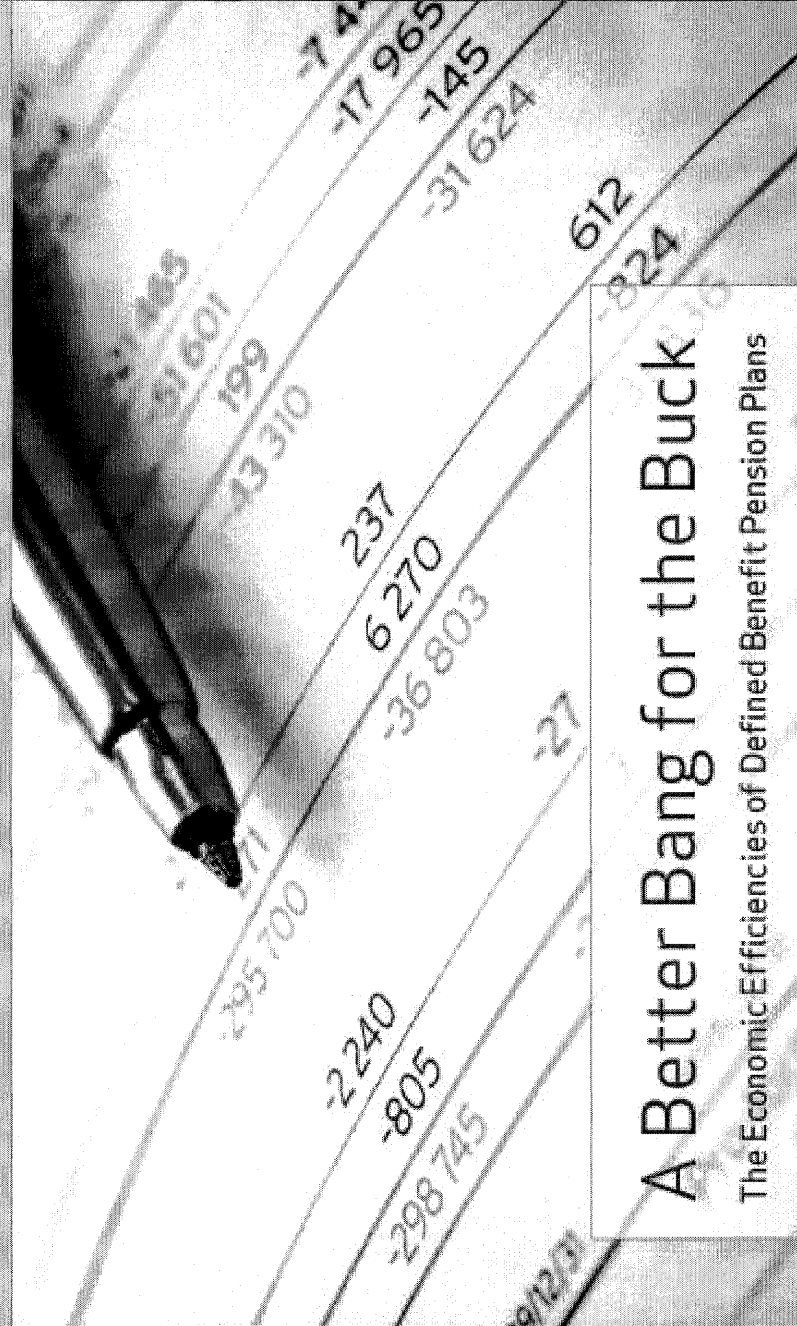
- State and local pensions do more than provide a critical source of reliable income for 7.3 million retired Americans and 35,000 retired Alaskans.
- They support 2.5 million American jobs and \$358 billion in national economic activity.
- They support 6,270 Alaskan jobs and \$1 billion in economic activity.
- Pensions are “automatic stabilizers” – retirees can continue to spend on basic needs, providing important stimulus during these tough times.





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Reliable Research. Sensible Solutions.



A Better Bang for the Buck

The Economic Efficiencies of Defined Benefit Pension Plans

by Beth Almeida and William B. Fornia, FSA

August 2008

Research Question: Why We Did this Study

- Evaluate claims that “DC plans save money”
- How do the costs of delivering retirement benefits through each type of plan compare?
 - Apples-to-apples comparison
 - Calculate the cost to deliver the same level of retirement benefits
 - DB plan
 - DC plan



Methodology: What We Did

- We model a population of 1,000 female teachers who work for 30 years - their final salary is \$50,000
- We define a “target” retirement benefit - about \$2,200/month – at age 62, which is adjusted for inflation
- We calculate the cost to fund this benefit through a DB plan structure, then through a DC plan structure



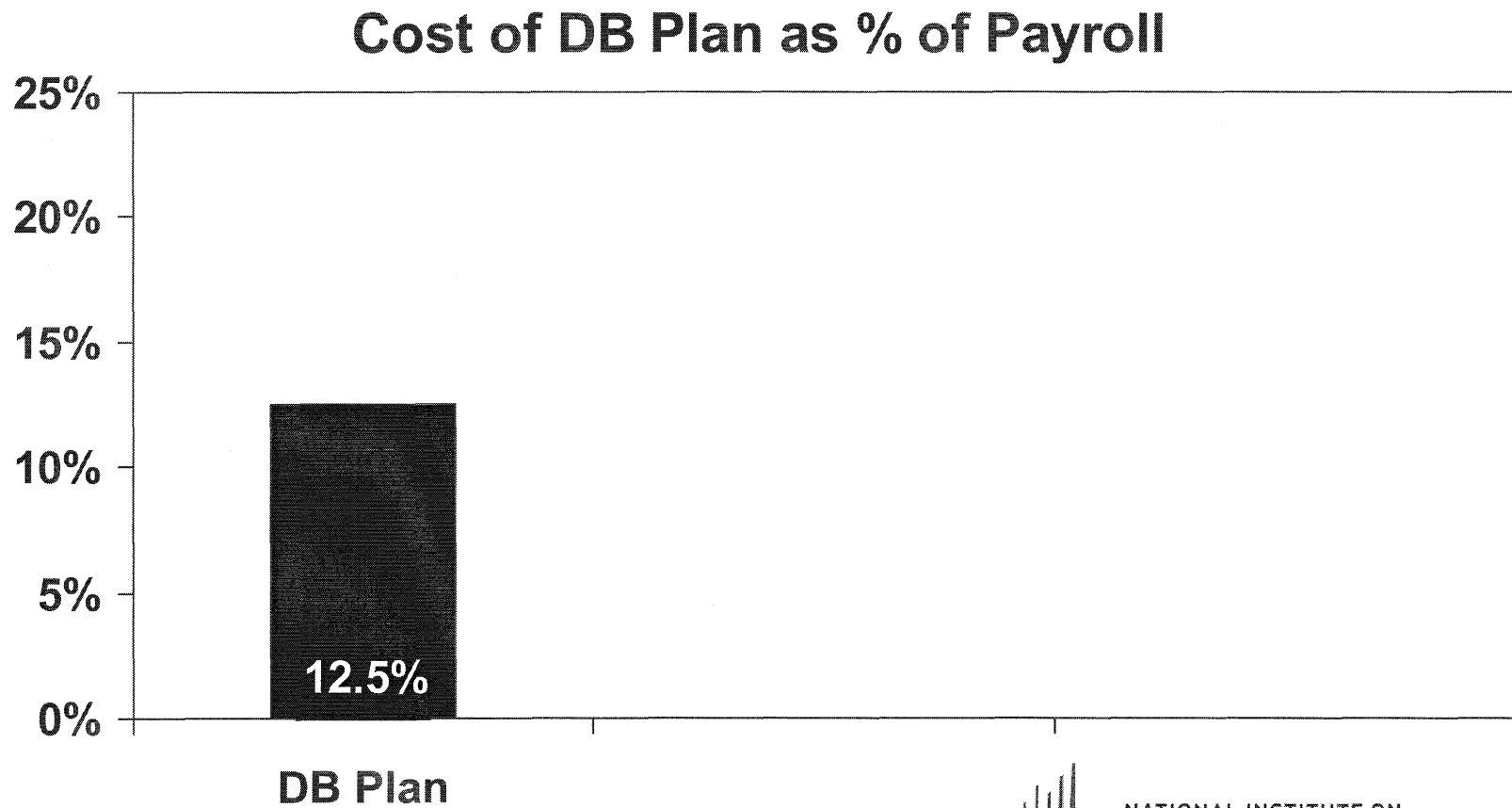
Results:

What We Found

- The DB approach saves money compared to the DC approach. Three reasons ...
 1. DB pension plans pool “longevity risks”
 2. DB pension plans can maintain a better diversified portfolio because, unlike individuals, they do not age
 3. DB pension plans achieve better investment returns because of professional asset management and lower fees



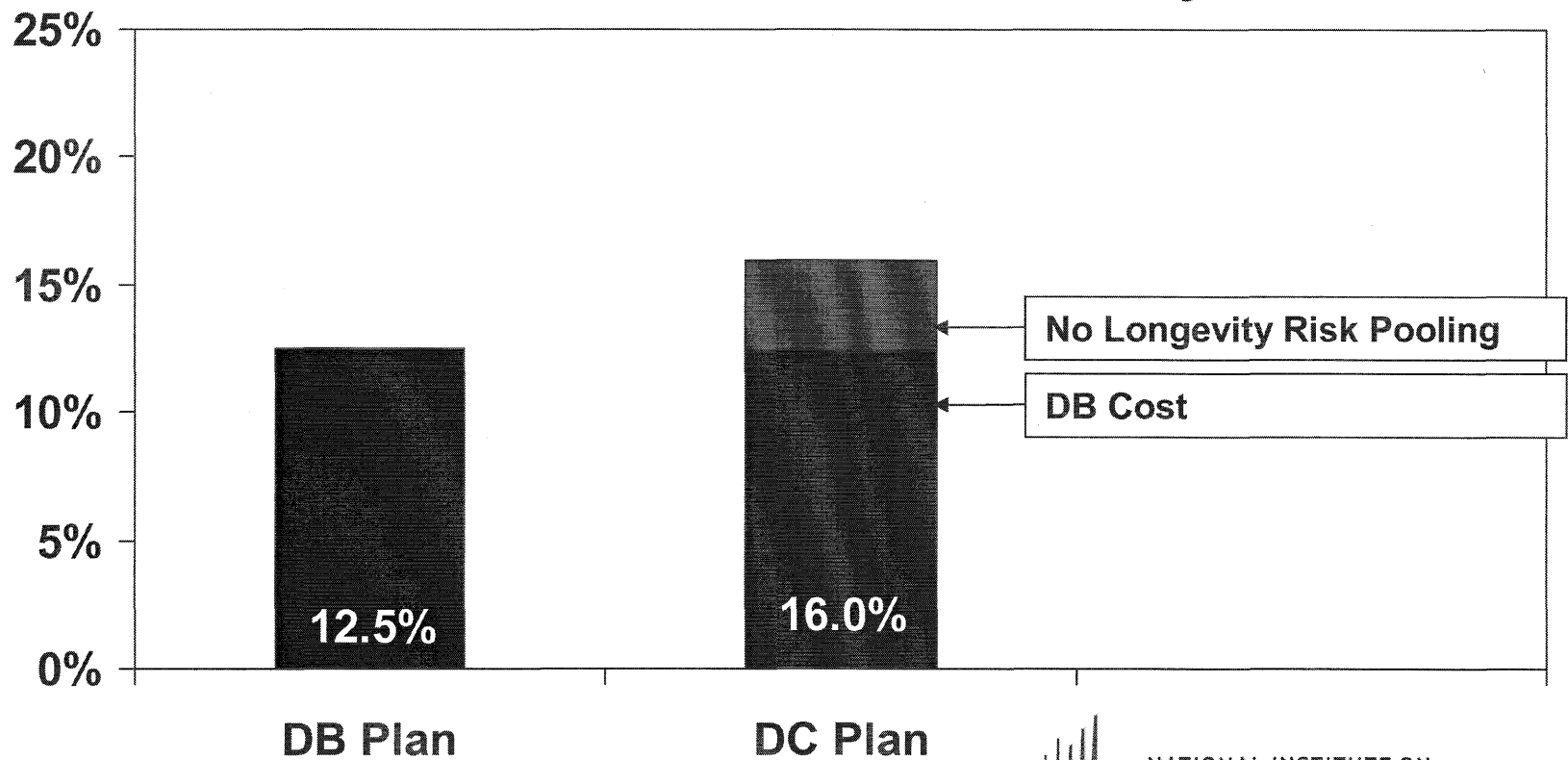
Our DB Plan Costs 12.5% of Payroll



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Lack of Longevity Risk Pooling in DC Plans Adds Cost

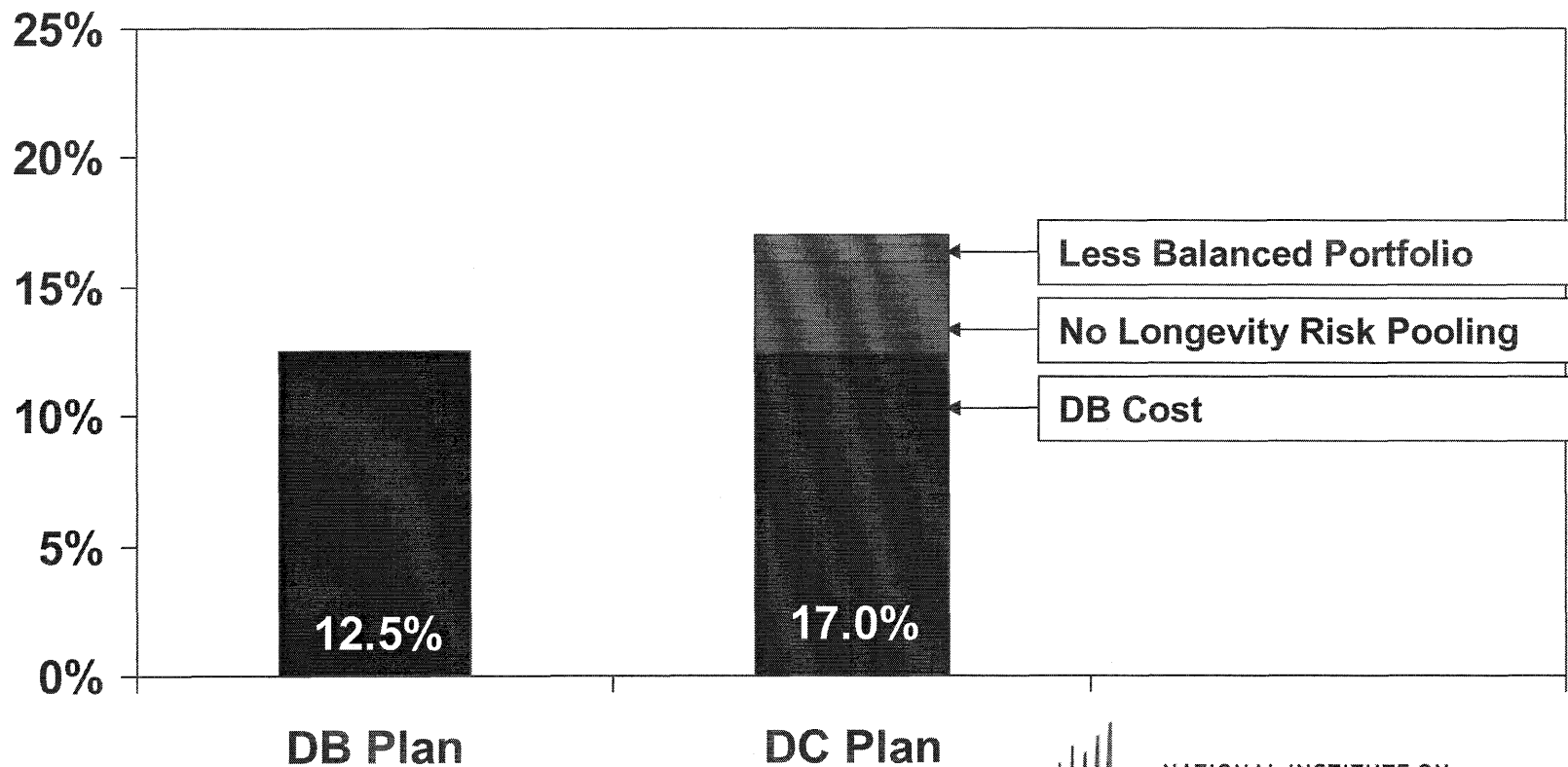
Cost of DB and DC Plan as % of Payroll



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Age-Based Portfolio Shift in DC Plans Adds Costs

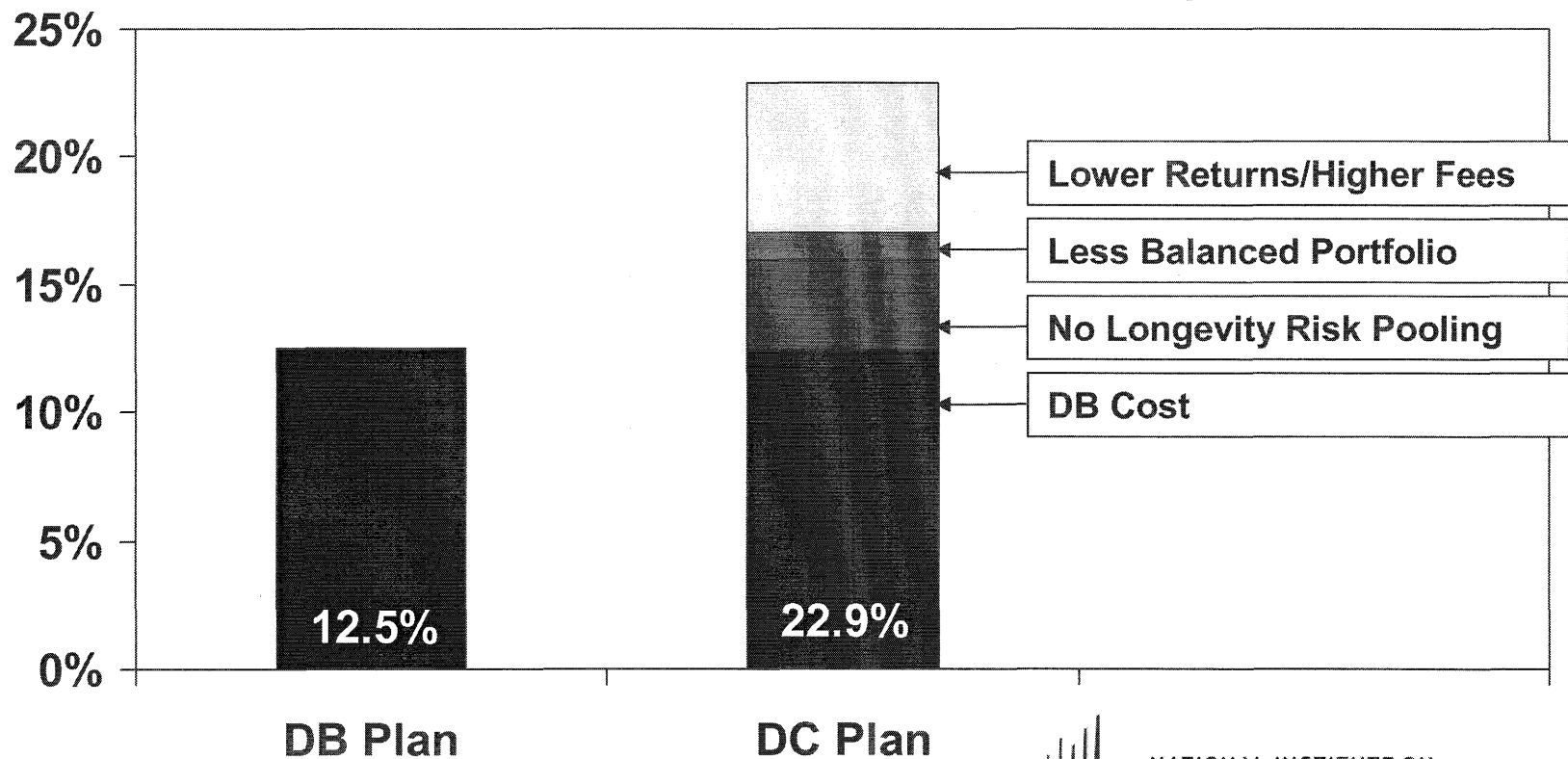
Cost of DB and DC Plan as % of Payroll



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Lower Returns/Higher Fees in DC Plans Adds Cost

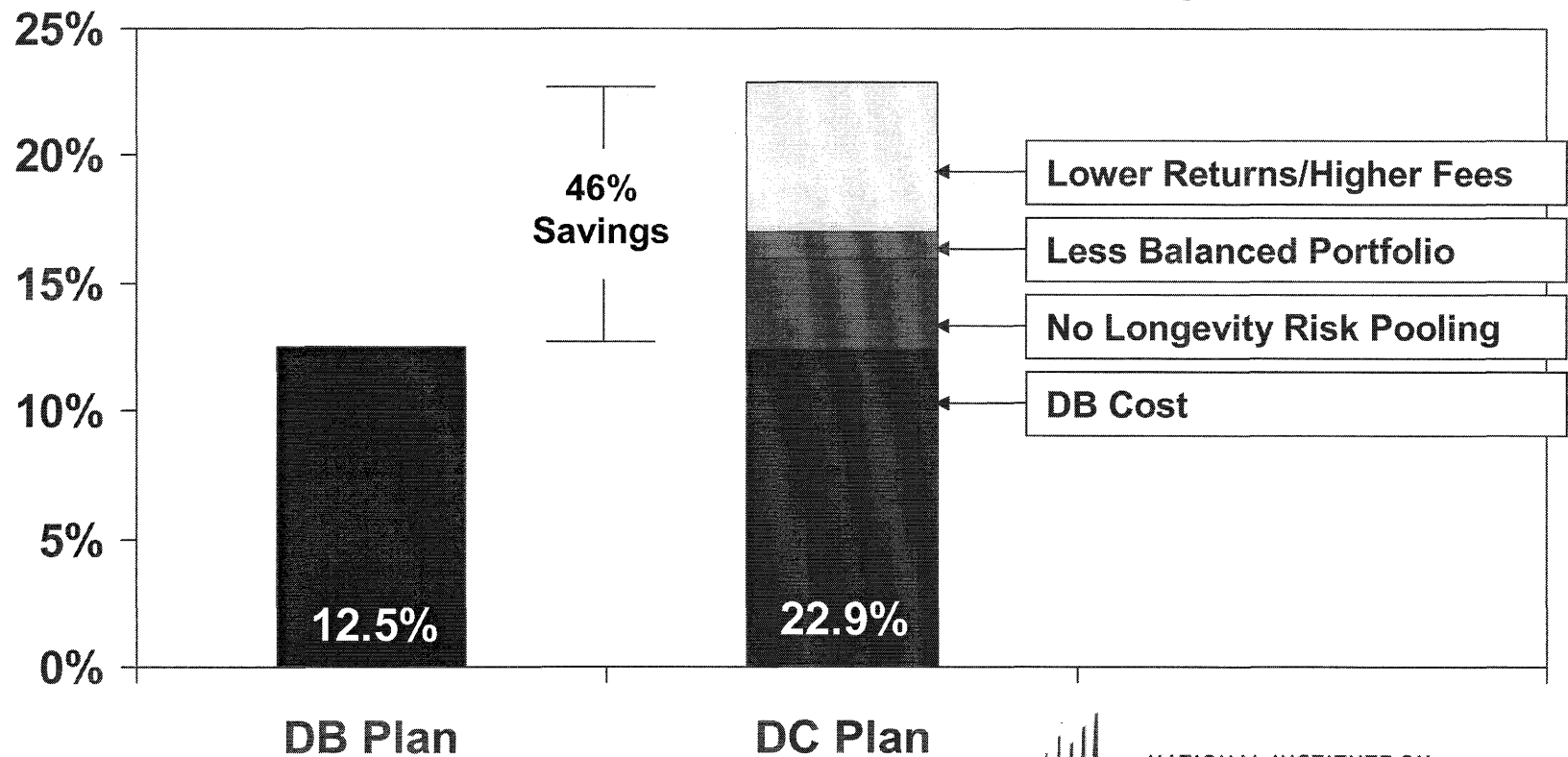
Cost of DB and DC Plan as % of Payroll



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DB Plan Can Deliver Same Benefit at About Half the Cost of DC Plan

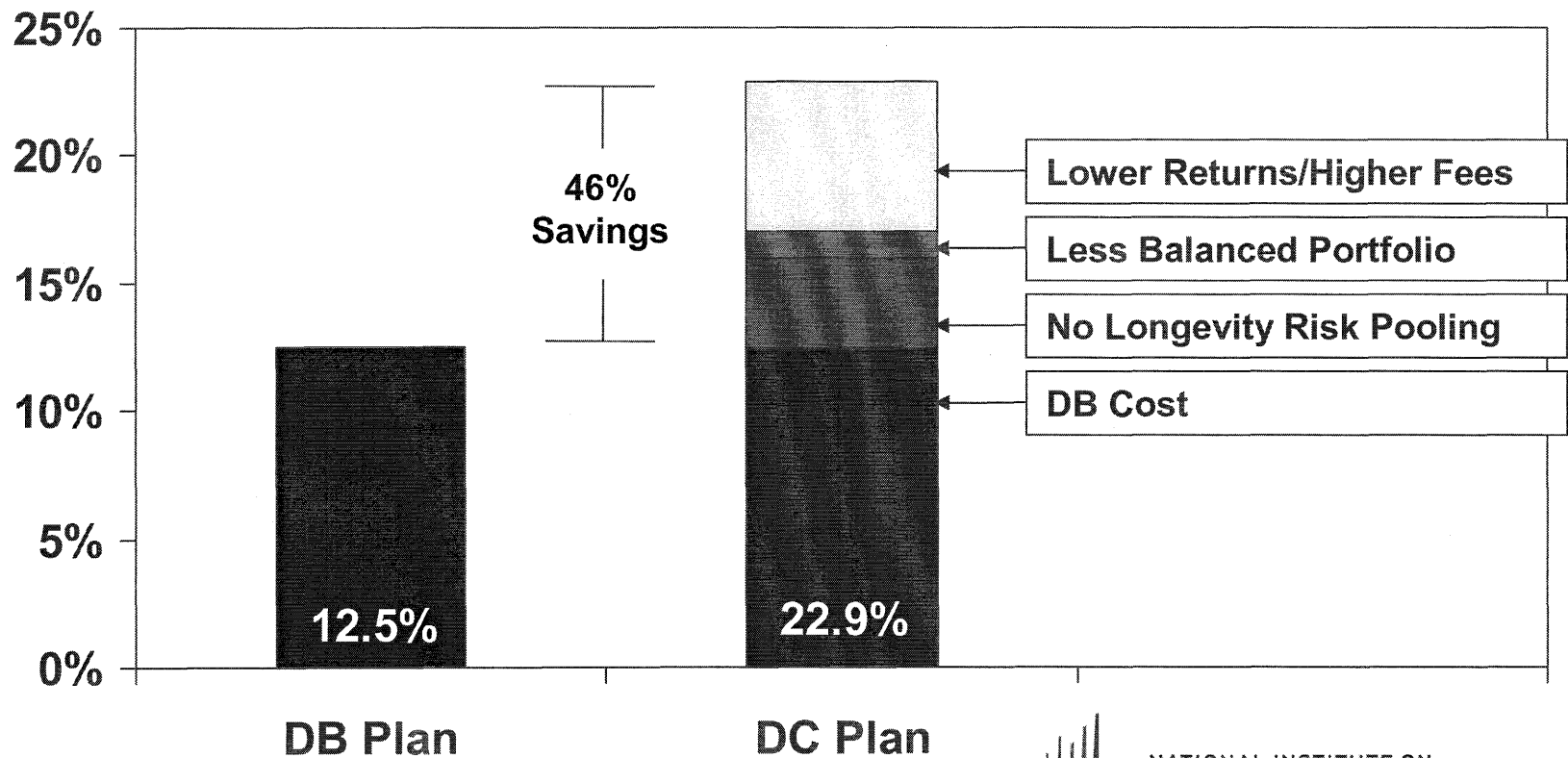
Cost of DB and DC Plan as % of Payroll



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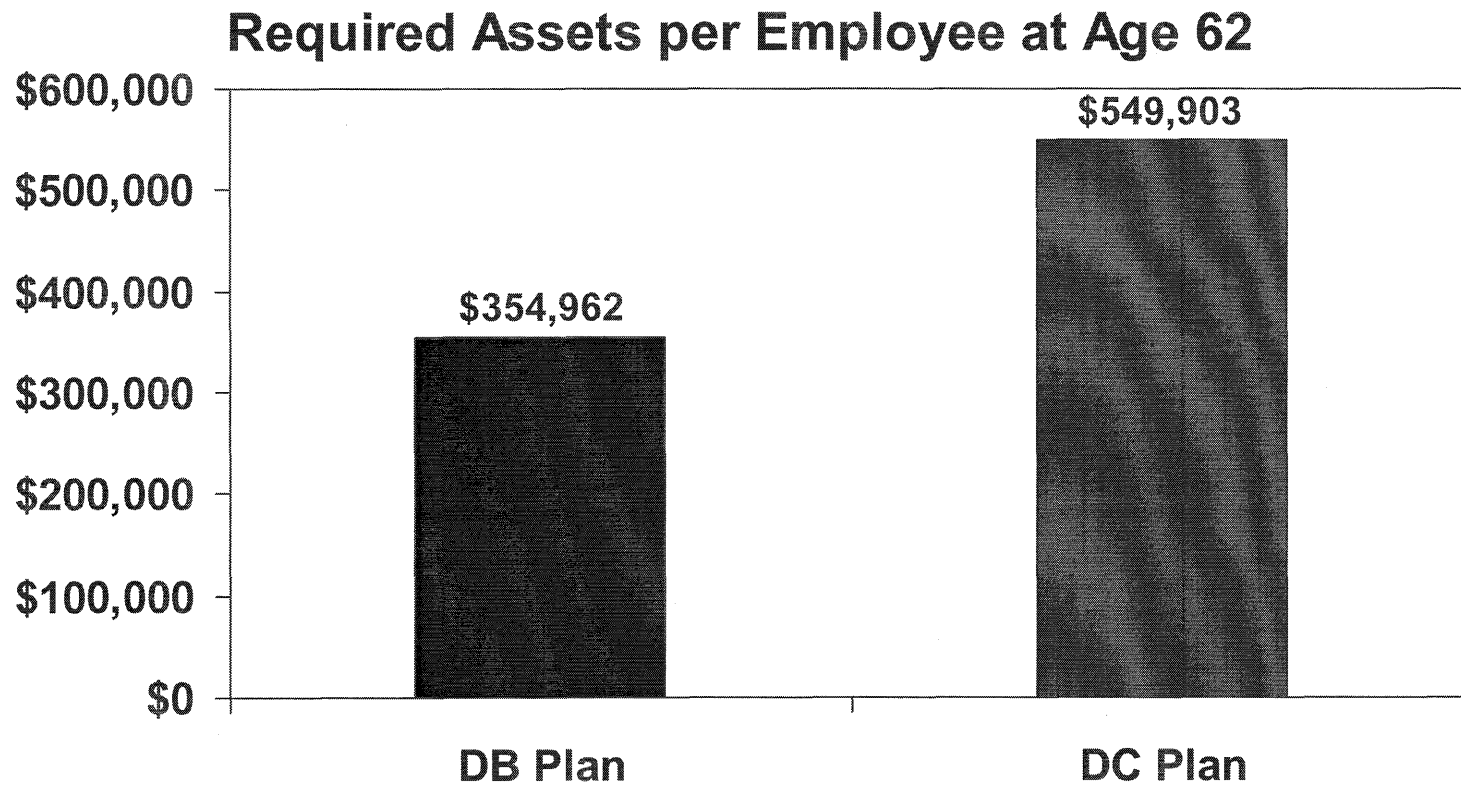
DB Plan Can Deliver Same Benefit at About Half the Cost of DC Plan

Cost of DB and DC Plan as % of Payroll



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DB Plan Can Do More with Less



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Report Conclusions

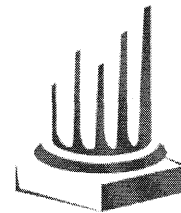
- DB plans have built-in economic efficiencies – provide a “better bang for the buck”
- These efficiencies drive significant cost savings for taxpayers and employers
- Decision makers should continue to carefully evaluate claims that “DC plans will save money”



Questions, Comments & Contact Info

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Reliable Research. Sensible Solutions.

State of Alaska

**Actuarial Audit of
TRS & PERS**

October 24, 2002

Mark O. Johnson, F.S.A.
Consulting Actuary

A MILLIMAN GLOBAL FIRM



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October 24, 2002

Mr. Guy Bell, Director
Department of Administration
Division of Retirement and Benefits
333 Willoughby Ave., 6th Floor
Juneau, AK 99811

Re: 2002 Actuarial Audit of TRS & PERS

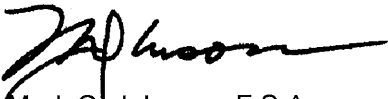
Dear Mr. Bell:

The enclosed report presents our findings and comments resulting from a detailed review of the actuarial services currently performed by your retained actuary, William M. Mercer, Inc. (Mercer). Milliman USA, Inc. was selected to perform this review following an RFP process completed in June of this year.

Our findings are categorized under two levels of significance to the overall financing of the Systems, and summarized in Section 1. More detailed commentary on our review process and suggested considerations for adjustments to actuarial assumptions or procedures are included in subsequent sections of this report.

We wish to express our appreciation for the cooperation provided to us by the Mercer consultants, you and your staff. We look forward to discussing our report with you and the two Boards of Trustees on October 24, 2002.

Sincerely,



Mark O. Johnson, F.S.A.
Consulting Actuary

**Alaska Division of Retirement and Benefits
2002 Actuarial Audit of TRS & PERS**

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Alaska Division of Retirement and Benefits

2002 Actuarial Audit of TRS & PERS

Section 1

Summary of Recommendations

Purpose and Scope of the Actuarial Audit Review

The purpose of an actuarial audit is to review the work performed by the Systems' actuary to assure the actuarial condition of each System is accurately measured, and that the contribution rate, together with the current assets, is sufficient to provide the benefits promised to members. You need to have an opinion regarding the accuracy and reasonableness of the following:

- The reasonableness, consistency and accuracy of the method, factors, and assumptions used in the actuarial valuations,
- The reasonableness, consistency and accuracy of the compilation of the actuarial valuation, and
- The reasonableness, consistency and accuracy of the results and the actuarial assumptions generated from the experience study.

Our specific methodology for the actuarial audit services requested was discussed in our proposal. We have followed all of the steps outlined in the proposal

Performing an actuarial audit is similar to doing detective work. The auditing actuary is presented with a set of facts, the "clues", and then tries to reconstruct the past events based on the available data. The auditing actuary's information is never as complete or detailed as that available to the retained actuary. Nevertheless, the purpose of the audit is to have the auditing actuary acquire a certain level of confidence that the findings and the results of the retained actuary's work are reasonable and were performed according to generally accepted actuarial standards and principles.

Outstanding Issues

Over the next month, we will complete the following tasks:

- Review the individual employer rate calculations,
- Validate the accounting disclosures, and
- Suggest areas for improvements in the reporting of the findings.

We will be available, as requested, to answer questions about our reviews and provide additional comments as warranted.



Alaska Division of Retirement and Benefits 2002 Actuarial Audit of TRS & PERS

Statement of Key Findings

Based upon a thorough review of the 2000 experience studies and the 2001 actuarial valuation reports, including the underlying data and calculations, we found the actuarial work to be generally reasonable. The valuations were performed in accordance with generally accepted actuarial standards and principles. However, we found a number of areas where changes are needed, and have additional observations and recommendations for improving the actuarial process.

This report includes a detailed discussion of all the elements of our review. The major issues are categorized under two levels of significance to the overall funding status of the Systems.

- Level A*** Areas where changes are needed which will result in a financial impact on the actuarial findings. Because we did not perform a replication audit, we will only be able to offer a "broad-brush" directional analysis of the fiscal impact our findings.

- Level B*** Areas where we recommend changes based on our professional opinions or preferences.

These issues are outlined on the following pages. Our observations and recommendations are discussed in later sections of the report in more detail.

Alaska Division of Retirement and Benefits 2002 Actuarial Audit of TRS & PERS

Level A Findings

Areas where changes are needed which will result in a financial impact on the actuarial findings:

1. TRS: Salary data was collected for the year ending on the valuation date and was used without escalation in the first projected year after the valuation. The Actuarial Liability for active member pensions is understated by one-year's wage growth and merit salary scale.
(understated liabilities)
2. PERS: Salary data was collected for the six-month period ending on the valuation date and was used without escalation in the first projected year after the valuation. The Actuarial Liability for active member pensions is understated by one-half-year's wage growth and merit salary scale.
(understated liabilities)
3. TRS: The salaries for part-time members are not converted to the equivalent full-time rate to project retirement benefits.
(understated liabilities)
4. TRS & PERS: The projected death benefits are calculated without the application of the joint & survivor factors.
(overstated liabilities)
5. TRS & PERS: The projected disability benefits for currently active members do not include service beyond the normal retirement age.
(understated liabilities)
6. PERS: P&F occupational disabilities are always projected at 66.67% of compensation.
(overstated liabilities)
7. PERS: Alaska COLA is assumed to be payable to 71% of retired members for some valuation calculations, even though the last experience study reduced this assumption to 68% of retired members.
(overstated liabilities)

We have discussed all of these technical issues with Mercer and they have indicated their concurrence with our findings. We understand Mercer is currently working on the fiscal impact of making the appropriate changes.

Alaska Division of Retirement and Benefits 2002 Actuarial Audit of TRS & PERS

Level B Findings

Areas where we recommend changes based on our professional opinions or preferences:

8. TRS & PERS: We believe the entire set of methods should be reviewed as a package. A number of the methods in use are unusual and may not, under certain conditions, provide the level of conservatism or stability the Boards desire. We have alternative suggestions to consider for the actuarial cost method, the amortization strategies, and the asset valuation method.
9. TRS & PERS: We recommend the assumption for future medical cost increases be reviewed prior to every valuation. In addition, we recommend the starting point for future projections be pegged to the latest known blended premium rather than an adjusted previous level.
10. TRS & PERS: We recommend the merit salary scale be reviewed carefully with consideration for a graded schedule with higher increases in the early years of employment.
11. TRS: The valuation assumes one simplified set of early retirement reduction factors to predict early retirement benefits. We recommend that the actual factors be used in the valuation.
12. TRS & PERS: The valuation assumes the resident COLA is applied to the entire benefit, rather than only to the basic benefit.
13. PERS: The valuation determines which tier the active member belongs to. We recommend the Systems provide Mercer with a data code, if possible, that indicates each non-retired member's tier.
14. TRS & PERS: The census data provides insufficient detail for the actuary to accurately predict future retirement benefits for vested terminated members. We recommend that Mercer work with the Systems to develop an accrued benefit or improved information on pay and service histories.
15. The observation period for the Experience Studies should be at least four years, rather than the two-year period used in the latest studies.
16. The Experience Studies and the Actuarial Valuations should provide more depth of information. We will provide detailed suggestions in a later report.

Alaska Division of Retirement and Benefits

2002 Actuarial Audit of TRS & PERS

Section 2

Actuarial Cost Method

Audit Conclusions

The actuarial cost method used is acceptable and meets generally accepted actuarial standards. However, the overall funding mechanism for TRS and PERS is unusual and includes elements that do not consistently reflect a cohesive funding policy. We recommend that the entire set of methods be reviewed as a package.

Actuarial Cost Method

The cost method used by Mercer is the Projected Unit Credit (PUC) method. The standard PUC method spreads the cost of benefits over each individual's working lifetime as service is accrued. The major components of the method are described below.

- **Normal Cost:** The cost allocated to the current year is called the Normal Cost. Under this method, the Normal Cost is equal to the present value of benefits expected to be paid in the future with respect to the service earned in the year subsequent to the valuation date.
- **Actuarial Liability (AL):** The Actuarial Liability, sometimes referred to as the Accrued Liability, is equal to the present value of all benefits expected to be paid in the future with respect to service performed up to the valuation date.
- **Unfunded Actuarial Liability (UAL):** Once the Actuarial Liability is determined, the Unfunded Actuarial Liability (UAL) is determined by subtracting the Actuarial Value of Assets. If the Actuarial Value of Assets exceeds the AL on the valuation date, the UAL is negative and the system has an Actuarial Surplus. The UAL (whether the system is in an unfunded or surplus position) is amortized over a rolling 25-year period by contributions in addition to (or as a credit against) the Normal Cost.

In our opinion, the basic funding method used by Mercer as described above is a well-recognized and generally reasonable method. However, from our perspective, this method can produce rising Normal Costs under certain emerging demographic circumstances. For instance, if the active population is aging, the Normal Cost expressed as a percentage of payroll may increase. The active membership may have an increasing attained age if the new entrants are hired at older ages than in the past, which is a real possibility with today's population.

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The Survey of State and Local Government Employee Retirement Systems, published by the Government Finance Officers' Association Research Center, is a broad based and well-recognized source of information about public employee retirement systems. The latest survey shows the following breakdown of actuarial cost methods used by public retirement systems. Note at the time of this survey that the PUC method was the second most popular method, but only used by 11% of the reporting systems.

<i>Table 1</i>	
Actuarial Cost Method	Percent of Total
Entry Age	75%
Projected Unit Credit	11
Aggregate	10
Other	<u>4</u>
All Reporting Systems	100%

We believe the Entry Age method is the most popular actuarial cost method for public sector retirement systems because it does a superior job of producing stable contributions as a percentage of an increasing payroll. From a budgetary standpoint, many systems are looking for contribution rate stability.

It is difficult to determine from the published actuarial reports what impact the average attained age has had on the TRS and PERS liabilities because of improvements to the data over the past several years. Nevertheless, we believe it is true that, if all other experience follows the actuarial assumptions, the Normal Costs of TRS and PERS will tend to increase over time if the average age of the active members increases over time. There is evidence that the average age of public employees across the country has been increasing as the age of the available workforce has increased.

We recommend that Mercer periodically monitor the Normal Cost as a percentage of salaries and determine if costs are expected to increase in the future. One way to measure this is to calculate the Normal Cost Rate using the Entry Age actuarial cost method and compare it to the current Normal Cost Rate under the PUC method.

Target Funding Ratio

One aspect of the funding policy for PERS is referred to as the 102% Target Funding Ratio. This adds a level of conservatism to the determination of the average contribution rate. A projection valuation is used to ascertain several factors that are used to adjust the current Actuarial Liability. The end result is a Past Service Rate that includes a margin for conservatism. Although the concept is laudable, the documentation of the

Alaska Division of Retirement and Benefits 2002 Actuarial Audit of TRS & PERS

calculation should be more complete. It is a challenge to understand the mechanics of the adjustment. We did not validate these calculations.

Amortization

There are two elements of the cost method that require the calculation of an amortization payment or credit: the Past Service Rate and the Contribution Rate Adjustment.

Past Service Rate: The Target Unfunded Liability is amortized as a fixed dollar amount over a rolling 25-year period. That is, the amortization payment is recalculated every year based on a new 25-year schedule. Since the amortization payment is recalculated every year, the method is not intended to fully amortize the Unfunded Liability.

In column (A) of the following Table 2, we have demonstrated how an Unfunded Liability would be amortized under this method. Notice that, if the experience follows all of the actuarial assumptions for the entire period, less than 30% of the UL is amortized after 25 years (\$718 remains from a \$1,000 UL). Also note in column (D) that the Amortization Rate, or Past Service Rate, declines as a percentage of the increasing payroll.

One rationale for using this amortization method is that there is an expectation that future actuarial gains will offset the current UL, or if there is a Surplus, that future actuarial losses will offset the current Surplus. This is not unreasonable and, in fact, it is permissible under the rules of the Governmental Accounting Standards Board (GASB). However, because the method is so slow to reduce the current balance, and the typically volatile investment gains and losses are handled separately, we support a change.

In column (B) we have changed the amortization from a rolling 25-year period to a fixed 25-year period. You can see that at the end of the period, the entire UL is amortized. The fixed dollar amortization payment in this example is \$88 per year, which is shown in column (E) as a decreasing percentage of the increasing payroll. This is a relatively conservative approach to amortizing the UL over the 25-year period because the payments are higher in the earlier years as a percentage of salaries.

The third approach is to calculate the amortization payment such that it remains a level percentage of salaries over the 25 years. Column (F) shows an amortization rate of 0.65% of salaries every year. As you can see in column (C), the UL balance actually increases for seven years then starts to decline, passing the \$1,000 mark after 14 years. The amortization accelerates more rapidly in the later years as the 0.65% amortization rate is applied to the increasing payroll.

The Boards should consider a fixed amortization period if the primary goal is to be conservative when there is a UL, or a fixed period and level rate if the desire is to produce contribution rate stability.

**Alaska Division of Retirement and Benefits
2002 Actuarial Audit of TRS & PERS**

Table 2

Year	Expected Remaining UL			Amortization Rate		
	Rolling Dollar	Fixed Dollar	Fixed Percent	Rolling Dollar	Fixed Dollar	Fixed Percent
	(A)	(B)	(C)	(D)	(E)	(F)
1	\$ 987	\$ 987	\$1,015	0.88%	0.88%	0.65%
2	974	973	1,029	0.84%	0.85%	0.65%
3	961	957	1,041	0.80%	0.82%	0.65%
4	948	940	1,052	0.76%	0.79%	0.65%
5	936	922	1,060	0.72%	0.76%	0.65%
6	923	903	1,066	0.68%	0.73%	0.65%
7	911	881	1,069	0.65%	0.70%	0.65%
8	899	858	1,068	0.61%	0.67%	0.65%
9	887	834	1,065	0.58%	0.65%	0.65%
10	876	807	1,057	0.55%	0.62%	0.65%
11	864	778	1,045	0.52%	0.60%	0.65%
12	853	746	1,027	0.50%	0.57%	0.65%
13	841	712	1,004	0.47%	0.55%	0.65%
14	830	675	976	0.45%	0.53%	0.65%
15	819	635	940	0.42%	0.51%	0.65%
16	809	592	896	0.40%	0.49%	0.65%
17	798	545	844	0.38%	0.47%	0.65%
18	787	494	783	0.36%	0.45%	0.65%
19	777	439	712	0.34%	0.44%	0.65%
20	767	380	629	0.33%	0.42%	0.65%
21	757	315	533	0.31%	0.40%	0.65%
22	747	245	424	0.29%	0.39%	0.65%
23	737	170	300	0.28%	0.37%	0.65%
24	727	88	159	0.26%	0.36%	0.65%
25	718	0	0	0.25%	0.34%	0.65%

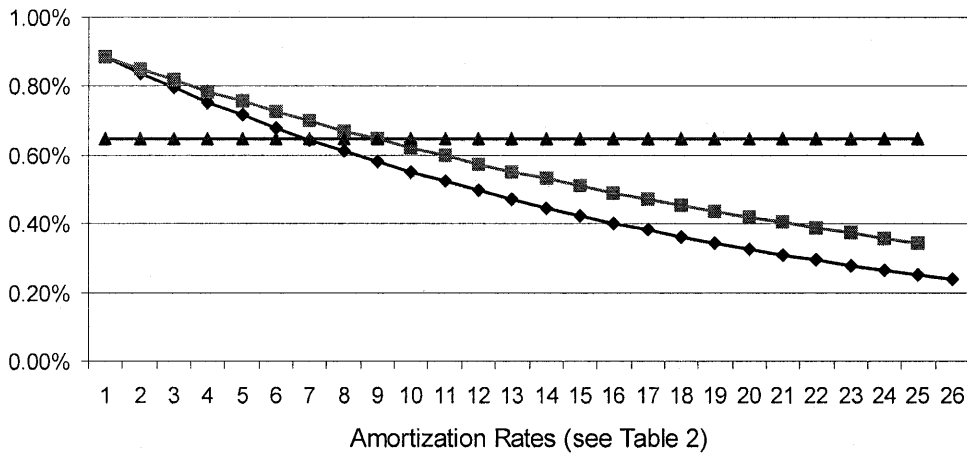
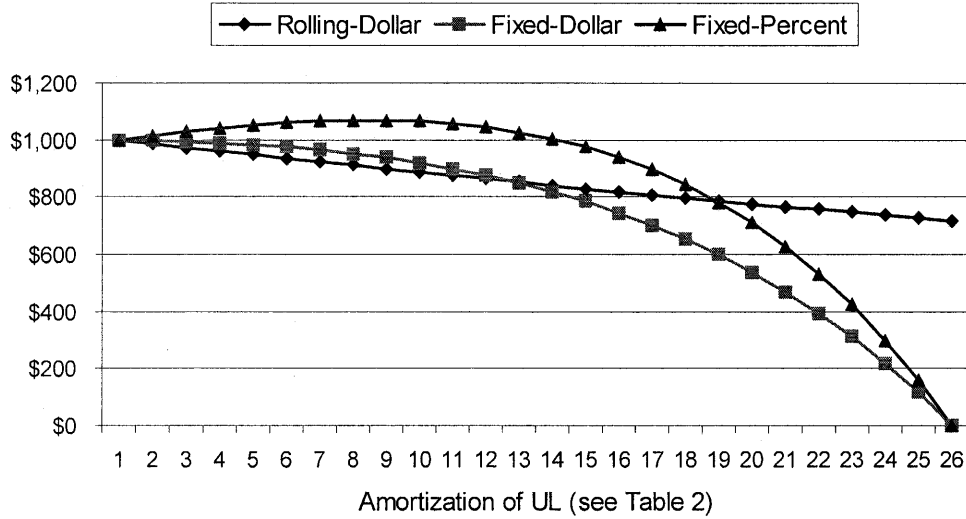
Assumptions:

Beginning Salaries: \$10,000
Beginning UL: \$1,000 (10% of Total Salaries)

Salary Increases: 4.00% per year
Discount Rate: 8.25% per year
Population Growth: 0.00% per year

The charts on the next page depict the declining balances of the UL under these three methods, and the amortization contributions as a percentage of payroll.

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Contribution Rate Adjustment: The asset smoothing method, discussed in the next section, includes the amortization of any outstanding balance of previously deferred amounts outside the 5% market value corridor. The amortization of this amount is calculated under a completely different method than the Past Service Rate.

The net deferred amount outside the corridor is amortized as a 20-year payment or credit calculated as a level percentage of salaries increasing with inflation and a 1% per

Alaska Division of Retirement and Benefits 2002 Actuarial Audit of TRS & PERS

year growth the active membership. Table 3 compares this amortization method with the amortization of the Past Service Rate.

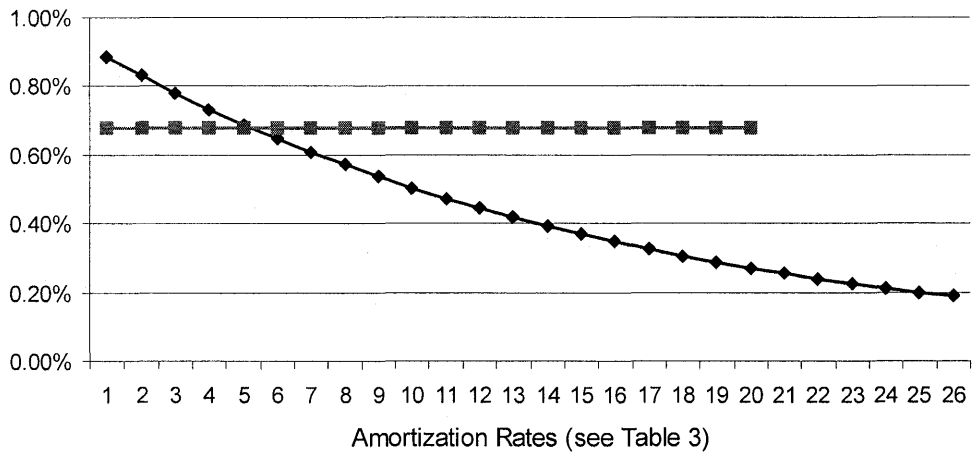
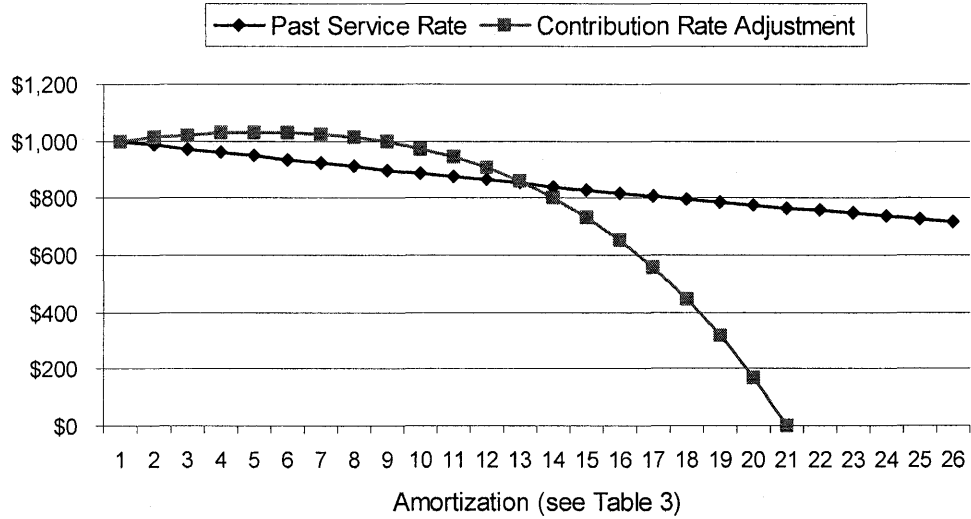
Table 3				
Year	<u>Expected Remaining UL</u>		<u>Percent of Salary Amortization Rate</u>	
	PSR (A)	Assets (B)	PSR (C)	Assets (D)
1	\$ 987	\$1,012	0.88%	0.68%
2	974	1,021	0.83%	0.68%
3	961	1,027	0.78%	0.68%
4	948	1,030	0.73%	0.68%
5	936	1,029	0.69%	0.68%
6	923	1,024	0.65%	0.68%
7	911	1,013	0.61%	0.68%
8	899	997	0.57%	0.68%
9	887	974	0.54%	0.68%
10	876	944	0.50%	0.68%
11	864	906	0.47%	0.68%
12	853	859	0.44%	0.68%
13	841	801	0.42%	0.68%
14	830	733	0.39%	0.68%
15	819	652	0.37%	0.68%
16	809	556	0.35%	0.68%
17	798	446	0.33%	0.68%
18	787	318	0.31%	0.68%
19	777	170	0.29%	0.68%
20	767	0	0.27%	0.68%
21	757	0	0.25%	0.00%
22	747	0	0.24%	0.00%
23	737	0	0.22%	0.00%
24	727	0	0.21%	0.00%
25	718	0	0.20%	0.00%

Assumptions:

Beginning Salaries: \$10,000
Beginning UL: \$1,000 (10% of Total Salaries)

Salary Increases: 4.00% per year
Discount Rate: 8.25% per year
Population Growth: 1.00% per year

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Because the two amortization methods are so dissimilar, we recommend that Mercer review the amortization policies to ensure the Boards' goals are being met.

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Governmental Accounting Standards Board

Mercer states the assumptions and methods used for funding purposes and for the disclosures presented in this report satisfy the parameter requirements set forth under the Governmental Accounting Standards Board (GASB) Statement No. 25.

The contribution rates developed in the valuations include an amortization schedule using a projected membership population. GASB No. 25 is very specific that if the amortization of an Unfunded Liability is amortized as a level percentage of payroll, the assumed payroll growth should not include an assumed increase in the number of active plan members.

The recommended contributions for TRS and PERS do not comply with the parameters permitted for the calculation of the Annual Required Contribution (ARC) under GASB disclosure Statement No. 25. Therefore, a separate calculation for GASB No. 25 is required. Those calculations were not shown in the valuation reports. We will be reviewing the GASB calculations in the next phase of the audit.

Alaska Division of Retirement and Benefits

2002 Actuarial Audit of TRS & PERS

Section 3

Asset Valuation Method

Audit Conclusion

The underlying actuarial asset valuation method is fairly common, however, it contains several features that make it unusual. The corridor is narrow and the calculation and amortization of deferred investment gains and losses is complicated and not well documented in the valuation reports.

Basic Method

From an investment standpoint, the current fair value of assets is usually accepted as the true measure of the asset value. However, using fair value can lead to unstable measures of the funding status of a system due to temporary changes in the markets. Actuarial asset valuation methods smooth out temporary aberrations in the fair value of assets, thus minimizing such instability.

An effective asset valuation method would:

- Produce values for the total fund that are relatively stable from year to year to avoid undue increases and decreases in the resulting funding requirements. The method should offset any temporary fluctuations in the market.
- Produce realistic values that are also acceptable to others. This would include consideration of accounting requirements, actuarial standards, and the expectation of a system's staff and membership. The actuarial standards of practice expect the actuarial valuation of assets to generally reflect some function of fair value.
- Be easily understood by others and not be unduly difficult either to explain or to calculate.
- Be independent of the rate of asset turnover. Although the method should be consistent with the funding policy of the system, it should not directly influence investment decisions nor should investment decisions directly influence the asset valuation method.
- The method should be consistent with the system's funding policy.



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The basic method used by Mercer conforms to the criteria shown above. However, there are two elements that we recommend be reviewed.

Corridor: The 5% corridor is very narrow relative to typical asset smoothing methods. A corridor of 20% is likely the most common, with some systems using a corridor as small as 10% and some not using a corridor at all.

Recognition of Deferred Gains and Losses: Generally, the deferred gains or losses are recognized over a period of three to five years. Once recognized, they become part of the Actuarial Value of Assets used to determine the Unfunded Liability. Once part of the Unfunded Liability, amortization proceeds in accordance with the funding policy. Both TRS and PERS have separate amortization policies for the recognition of previously deferred gains or losses.

A separately measured amortization of investment gains and losses is acceptable, however as mentioned in the previous section, the amortization is dissimilar to the amortization of gains or losses arising from the Actuarial Liability. As a result, the determination of the Actuarial Value of Assets and the Contribution Rate Adjustment are both relatively confusing.

The specific derivation of the Actuarial Value of Assets and the Contribution Rate Adjustment are not sufficiently documented in the valuation reports.

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Section 4

Actuarial Assumptions

Audit Conclusion

We reviewed all of the key actuarial assumptions and believe the assumptions recommended by Mercer are reasonable and appropriate with only a few exceptions: medical costs and merit salary increases.

Comments

The most recent experience studies were for the two-year period ending June 30, 1999, and are referred to as the 2000 Studies. Since the 2000 Studies were completed, two Actuarial Standards of Practice have been published which should encourage Mercer to provide more documentation of their findings in the future.

Our recommendations for changes in the assumptions are based on our actuarial judgment and experience with other public retirement systems, as well as a review of the underlying data for Mercer's 2000 Studies. A recommendation of change in an assumption does not necessarily indicate that those currently used are inappropriate.

In reviewing the assumptions currently used by Mercer, we are guided by the Actuarial Standards Board (ASB) Actuarial Standards of Practice No. 4, No. 27, and No. 35. The actuary is required by the standards to consider the reasonableness of each actuarial assumption independently on the basis of its own merits, of its consistency with each other assumption, and of the degree of uncertainty and potential for future fluctuations. Although a set of assumptions in the aggregate may appear to reflect the System's experience, failing to isolate the individual assumptions can lead to inappropriate results when a particular aspect of the plan or a change in the plan is under review.

Alaska Division of Retirement and Benefits 2002 Actuarial Audit of TRS & PERS

Economic Assumptions

In our opinion, based on the information and economic environment present in 2000, the economic assumptions recommended by Mercer were generally reasonable.

The Actuarial Standards Board has adopted Actuarial Standard of Practice (ASOP) No. 27, *Selection of Economic Assumptions for Measuring Pension Obligations*. This standard provides guidance to actuaries giving advice on selecting economic assumptions for measuring obligations under defined benefit plans. The 2000 Study presents evidence that the recommendations were developed in accordance with the applicable Actuarial Standards of Practice.

Because no one knows what the future holds, the best an actuary can do is to use professional judgment to estimate possible future economic outcomes. These estimates are based on a mixture of past experience, future expectations, and professional judgment. The actuary should consider a number of factors, including the purpose and nature of the measurement, and appropriate recent and long-term historical economic data. However, the standard explicitly advises the actuary not to give undue weight to recent experience.

Recognizing that there is not one "right answer", the standard calls for the actuary to develop a best estimate range for each economic assumption, and then recommend a specific point within that range. Each economic assumption should individually satisfy this standard. Furthermore, with respect to any particular valuation, each economic assumption should be consistent with every other economic assumption over the measurement period. The economic assumptions are much more subjective in nature than the demographic assumptions. The 2000 Studies recommended the following revisions to the economic assumptions:

Table 4		
Assumption	Prior Assumption	Revised Assumption
Inflation	4.00%	3.50%
Real Investment Return	<u>4.25</u>	<u>4.75</u>
Total Return	8.25%	8.25%
Inflation	4.00%	3.50%
Real Wage Growth	<u>0.50</u>	<u>0.50</u> *
Total Wage Growth	4.50%	4.00%
* 1.00% for P&F in PERS		

These changes are representative of the recognition that future inflation is not expected to be as high as was previously assumed, based on historical data. We have seen

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similar decreases in both the price inflation and wage inflation assumptions in other public sector plans.

At the same time, the investment return assumption has remained constant. This means that a greater net real rate of return is now expected from the portfolio. We believe this assumption was supportable in 2000.

The Board should be aware that the Actuarial Liability is directly impacted by these two important assumptions. First, the present values are highly sensitive to the "spread", which is the effective discount factor in determining the present value of benefits to active members. Secondly, the present value of benefits for retired members is impacted by the investment return assumption. The changes mean there has been a 0.50% per year increase in this spread (except for PERS P&F members). The change had the impact of lowering the Actuarial Liability for active members.

The current package of economic assumptions is reasonable, but more aggressive than the previous assumptions. Since economic assumptions are subjective in nature, it is our recommendation that the Board be fully comfortable with the implications of the assumptions. There is an "actuarial risk" associated with the economic assumptions the same as there is an investment risk associated with a given portfolio mix. The assumptions do not affect the actual long-term cost of a plan. The ultimate cost will emerge in accordance with the benefits and expenses that are actually paid.

Inflation: The inflation assumption is used in the valuation to build the assumptions for investment return and wage growth. To test the reasonableness of the 3.50% inflation assumption as of 2000, we used economic statistics that have been accumulated on a monthly basis from 1926 through 1999 and published by the Society of Actuaries. The data for inflation is based on the national Consumer Price Index, US City Average, All Urban Consumers (CPI-U). The data shows a compounded annual inflation rate for the period from 1926 through 1999 of 3.1%.

Since the Treasury Department started issuing inflation indexed bonds, it is possible to determine the approximate rate of inflation anticipated by investors by comparing the yields on inflation indexed bonds with traditional fixed government bonds. Market prices in 1999 suggested investors expected inflation to average about 2% over the ensuing five to ten years.

Most economists forecast inflation increases at lower levels than Mercer's current assumption of 3.5%, but are looking at shorter periods than appropriate for a pension plan. To find an economic forecast with a sufficiently long time frame, we looked at the expected increase in the CPI by the Office of the Chief Actuary for the Social Security Administration. In a recent Trustees report, the annual increase in the CPI over the next 30 years under the intermediate cost assumptions was 3.0% and the reasonable range presented was 2.0% to 4.0%.

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Although we believe inflation levels may turn out to be lower than currently assumed, we believe the 3.50% inflation assumption is reasonable. We concur with Mercer that a separate inflation assumption for the Post Retirement Pension Adjustments (PRPA) is not justified.

Wage Growth: Estimates of future salaries are based on two types of assumptions. Rates of increase in the general wage level of the membership are directly related to inflation, while rates of increase in individual salaries due to merit or promotion and longevity occur even in the absence of inflation.

The excess of wage growth over price inflation represents the increase in the standard of living, also called real wage growth. The 2000 Study contained a recommendation for productivity increases of 0.50% per year, except for the PERS P&F group, where the recommended increase is 1.00%.

Although we generally agree with the level of real wage growth increase in TRS and PERS, in our opinion, the reports should have demonstrated a basis for the real wage growth increases. In addition, it is uncommon to assume a different real wage growth, an assumption derived for the forecast of a general economic trend, for different groups within the same valuation. Increases in excess of across-the-board adjustments are normally handled in the longevity assumption.

We have used statistics from the Social Security System on the National Average Wage from 1951 through 1998 (these would have been available for the 2000 Study). For years prior to 1951 we studied the Total Private Nonagricultural Wages as published in Historical Statistics of the U.S., Colonial Times to 1970. This data shows a compounded annual increase from 1926 through 1998 of 4.6%.

Inflation for the same period was 3.1%, so the long-term real increase in wages has been about 1.5% per year. The difference between the compounded rate of wage increase and the rate of inflation has been decreasing.

Based on our judgment, we believe that a range between 0.25% and 1.00% is reasonable for the long-term real wage growth assumption. Therefore, based on an inflation assumption of 3.50%, we believe a reasonable range for wage growth is between 3.75% and 4.50%. The Mercer assumption fits within this range.

Investment Return: The investment return assumption is one of the primary determinants to allocate the expected cost of the Systems' benefits, providing a discount of the estimated future benefit payments to reflect the time value of money. The current assumption for investment return is 8.25% per year. We believe this is a reasonable assumption given the Systems' current asset allocation policies.

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The following description of the derivation of the 8.25% assumption contained in the 2000 Study followed the actuarial standard.

Table 5			
Asset Class	Expected Real Rate of Return	Policy Asset Allocation	Return by Class
Domestic Large Cap Equities	6.61%	29%	1.92%
Domestic Small Cap Equities	7.39	12	0.89
International Equities	6.81	17	1.16
Domestic Fixed Income	3.00	30	0.90
International Fixed Income	3.51	5	0.18
Real Estate	4.83	<u>7</u>	<u>0.34</u>
Total Fund		100%	5.39%

“Considering that the actual year-by-year returns achieved by PERS will be volatile, reflecting the risk associated with each asset class, it is often prudent to set the real return assumption below the full expectation. We believe a real return assumption between 4.50% and 5.00% would be appropriate, and when added to the long-term inflation assumption of 3.5% yields a nominal return of 8.00% to 8.50%. We are recommending that the Board continue to assume 8.25% for the interest rate.” (from Mercer’s experience study report)

Our following demonstration also shows that the 8.25% assumption was within a reasonable range in 2000. A formula-based model was used to predict future returns based on these capital market assumptions, the asset allocation policy, and assumed annual rebalancing. The asset allocation and the expected real returns and total returns by asset class are shown below.

Table 6				
Asset Class	Expected Real Rate of Return		Standard Deviation	
US Equities	6.80%		18.10%	
International Equities	6.90		19.20	
Real Estate	5.70		15.50	
Fixed Income	4.50		3.10	
Cross Correlation Matrix				
Asset Class	US Equity	Intl Equity	Real Estate	Fixed
US Equities	1.00			
Int'l Equities	0.58	1.00		
Real Estate	0.36	0.29	1.00	
Fixed Income	0.27	0.24	0.48	1.00

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These capital market assumptions were combined with the asset allocation policy shown in the 2000 Study to generate expected returns over a thirty-year period. The model assumes that investment returns are normally distributed and are based on mathematical formulas from *The Long-Term Expected Rate of Return: Setting it Right* by Olivier de la Grandville as published in the *Financial Analysts Journal*, Nov/Dec 1998.

The expected real rate of return of a portfolio allocated in this way is 5.94% for one year, which is slightly higher than the Mercer results shown in the 2000 Study. However, the return is subject to significant volatility. The model provides a guide to see if it is reasonable to expect this return to compound over longer periods of time. The results are summarized in the following table.

Table 7							
Horizon in Years	Mean	Std Dev	Percentile Results				
			5th	25th	50th	75th	95th
1	5.94%	10.5%	(10.5)%	(1.4)%	5.4%	12.7%	24.1%
10	5.47	3.3	0.1	3.2	5.4	7.7	11.0
20	5.44	2.3	1.6	3.8	5.4	7.0	9.3
30	5.43	1.9	2.3	4.1	5.4	6.7	8.6

In the first year, the mean real return is 5.94%, but due to the volatility associated with the asset allocation, the range of probable outcomes is quite large. For example, for a single year there is a 5% chance the return will be less than -10.5% and a 5% chance it will be greater than 24.1% based on these capital market assumptions. As the time horizon lengthens, the range of cumulative average results narrows.

Over a thirty-year time horizon, there is a 25% chance the real return will be less than 4.1% and a 25% chance the return will be greater than 6.7% (bold numbers on the bottom line in the table above). Therefore, we can say the real return is just as likely to be within the range from 4.1% to 6.7% as not. The median return over thirty years is expected to be 5.4%.

The investment return is assumed to be net of all investment-related and administrative expenses. The investment and administrative expenses, taken from the System's financial statements, are very modest. The expense ratio is calculated as the total expenses divided by the average asset balance during the year. Based on this data, it appears the annual investment and administrative expenses represent are about 0.3% of the Systems' assets.

Based on the ASOP No. 27 guidelines, we conclude that a reasonable range for the net investment return is from 7.3% to 9.9%.



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Table 8			
Components of Return	Percentile Results		
	25th	50th	75th
Real Investment Return	4.1%	5.4%	6.7%
Inflation	3.5	3.5	3.5
Assumed Expenses	<u>(0.3)</u>	<u>(0.3)</u>	<u>(0.3)</u>
Net Investment Return	7.3%	8.6%	9.9%

Based on this analysis, we concur that the net investment return assumption of 8.25% per year was reasonable based on available information and the economic environment in 2000. We believe an investment return assumption of 8.25% per year was consistent with the level of inflation and real rate of return likely to occur over an extended period of time, net of expenses.

Although comparing one system's assumptions to those of other systems has only limited importance in setting assumption, we did make several comparisons.

- The assumption of 8.25% was slightly high when compared with the assumptions made by other public systems at that time. The 2000 GFOA survey of state and local governmental employee retirement systems showed that the average assumed rate of return from the latest available actuarial reports was 7.88% for all systems.
- The biennial comparative study performed by the State of Wisconsin on 84 statewide systems showed a range from 7.0% through 9.0%, with an average of 8.0%. The rates of return were fairly well distributed, with over half of the systems using 8.0%, 20% using 7.5% and 20% using 8.5%.

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Medical Costs

One of the most critical assumptions in the valuation is the expected increase in medical costs. These costs have historically increased at a higher rate than the CPI. Although this is a difficult assumption to judge in the short term, we believe the current assumption and method should be more conservative. There are several elements of the process we wish to discuss.

Trend Assumption: The following table shows the assumption used in the last three valuations for TRS and PERS.

Table 9				
FY	Actuarial Valuation			Actual Increase
	1999	2000	2001	
1999	5.5%	-	-	20%
2000	5.5	8.5%	-	20
2001	5.5	7.5	7.5	15
2002	5.5	6.5	6.5	10
2003	5.5	5.5	5.5	-
2004-08	5.5	5.0	5.0	-
2009-13	5.5	4.5	4.5	-
2014 +	5.5	4.0	4.0	-

The change for the 2000 valuations was an appropriate response to the expectations for medical cost increases. We agree with the approach of starting at a high point and grading down to a level slightly higher than the long-term inflation assumption. Since the inflation assumption is 3.5%, it is appropriate for the ultimate assumption to be 4.0%.

We recommend that this assumption be reviewed prior to every valuation until such time as medical costs have stabilized close to the rate of price inflation. In our opinion, the 2001 valuations should not have simply moved one year down the schedule without a thorough review.

We believe the current assumption should be strengthened. Our healthcare actuaries would have recommended the assumption start within a range of 9% to 11% in 2001 with a gradual decline to about 5% (approximately the assumed level of price inflation plus the expected real rate of growth in the economy).

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Valuation Premium: The Mercer method is designed to enhance stability. We believe stability should be introduced through the amortization of liabilities rather than through the technique being used. Given the recent history of medical cost increases, the Mercer method can significantly understate liabilities if the actual increases are greater than the assumed increases.

Mercer anchored the blended premium several years ago and has escalated it by the assumed increases. Therefore, the blended premium used in the 2001 valuations was \$577.40 when the actual blended premium was \$668.00. This means the valuations are using a starting point for the projection of future medical costs that is almost 14% lower than the current blended premium. It would take three years for the assumed premium to catch up with the actual premium if there is no medical inflation during that time. This does not appear reasonable to us.

We recommend the valuations always adjust the starting point for future projections based on the latest actual premium levels.



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Demographic Assumptions

Demographic assumptions relate to the probability of an active member leaving the system and the promotional rate component of the salary increase assumption. We reviewed both the current demographic assumptions and the recent changes recommended in the 2000 Studies.

Actuarial Standard of Practice (ASOP) No. 35, *Selection of Demographic and Other Noneconomic Assumptions for Measuring Pension Obligations*, provides guidance to actuaries giving advice on selecting demographic assumptions for defined benefit plans, such as TRS and PERS. In our opinion, the demographic assumptions recommended in this report have been developed in accordance with ASOP No. 35.

Studies of demographic experience involve several steps.

- First, the number of members changing membership status, called decrements, during the study are tabulated by age, duration, sex and class of membership.
- Next, the number of members expected to change status is calculated by multiplying certain membership statistics, called the exposure, by the expected rates of decrement.
- Then, rates of decrement are calculated based on the actual results and compared with the current assumption.
- Finally, proposed new rates of decrement are developed based on the judgment of the actuary.
- Typically, the number of actual decrements is compared with the number of expected decrements by using the actual to expected ratio (A/E Ratio). This is a helpful tool to see how close the actual experience was to the assumption.

If the actual experience differs significantly from the overall expected results, or if the pattern of actual decrements or rates of decrement, by age, sex, or duration does not follow the expected pattern, new assumptions are considered. Recommended revisions normally are not an exact representation of the experience during the observation period. Judgment is required to predict future experience from past trends and current evidence, including a determination of the amount of weight to assign to the most recent observation periods.

The most recent experience study was for the two-year period ending June 30, 1999, and is referred to as the 2000 Studies. This is a very short observation period, particularly for systems as small as TRS and PERS. We recommend that the next studies use observed data from a period at least four years long. The advantage of a very short observation period, such as two years, is that the actuary can isolate a recent

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trend by comparing the results to previous study periods. However, the danger of looking at such a short observation period is that the actuary may be swayed by anomalies in the data or trend that will not emerge as a good representation of future experience.

Retired Member Mortality: This is an obviously critical assumption for appropriately calculating the liability for all retirees and beneficiaries. Given recent improvements in longevity, a margin is usually set to allow for additional improvements. This assumption is used to value not only benefits payable to the current retired members but also in projecting the value of future benefit payments to active members many years ahead. Thus, the extra margin is needed to assure that the liabilities for benefits for future retirees are adequate.

The life expectancies of current and future retirees are predicated on the assumed rates of mortality at each age. It is commonly known that rates of mortality have been declining throughout the last century, which means people, in general, are living longer.

Because of clear differences in mortality rates, healthy retirees and disabled retirees are usually studied separately. Disabled mortality was not studied separately for TRS and PERS, but this is acceptable since the number of disabled retirees is relatively small.

Typically we see a compilation of the actual deaths compared to the number of expected deaths in the observation period. Even for a relatively small group, this analysis will prove helpful. If the A/E Ratio is greater than 100%, fewer deaths were predicted than actually occurred, and there is some margin for future mortality improvements. Consider the sample we developed below.

<i>Table 10</i>			
<i>SAMPLE</i>	Actual	Expected	A/E Ratio
Observed Data			
Male	1,000	1,030	97%
Female	<u>1,000</u>	<u>990</u>	101%
Totals	2,000	2,020	99%
Revised Assumptions			
Male	1,000	925	108%
Female	<u>1,000</u>	<u>925</u>	108%
Totals	2,000	1,850	108%

In this illustration, the observed A/E Ratio for male retirees is under 100%, clearly showing that changes are warranted. Even though the A/E Ratio for female retirees is greater than 100%, the actuary may believe that changes are warranted to provide a

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greater margin for future mortality improvements. Once revised mortality assumptions are selected, the A/E Ratios are recalculated. In this illustration, the new A/E Ratios are 108%. In our experience, mortality margins between 5% and 10% are prudent.

We agree that a revision was needed, but without further information, we can't assess the margin included for future mortality improvements. We have two separate points on the mortality assumptions.

- There is clear evidence from the Society of Actuaries that relatively better educated individuals tend to live longer. For this reason, we also find in data from other states that teachers tend to live longer than non-teacher public employees. Note that the mortality assumptions for retirees in TRS and PERS are the same. We recommend that the next experience studies use the approach of compiling and comparing the A/E Ratios to determine the expected mortality margins in the two systems.
- Some systems use a different mortality table to predict the longevity of members who have not yet retired. The theory is that by the time the active members retire, the retired mortality will be improved which will in turn cause the actuary to revise the mortality assumption increasing the Actuarial Liability. By anticipating future retiree mortality improvements for active members, the sudden increase in the Actuarial Liability can be avoided.

Merit Salary Scale: The merit scale is based on years of service, and is independent of age and sex. The merit scale is a flat percentage and extends 5 years for TRS and P&F, and 10 years for other members of PERS. In our opinion, the assumptions are not consistent with the observed data. However, the patterns of the observed data are very consistent with the patterns we have seen in other states.

The observed data shows a markedly higher merit increase in the earliest years of membership, followed by a gradual decline over 10 to 20 years.

- **TRS:** Teachers typically have a very well defined salary scale with steps for longevity and additional educational requirements. The observed data is consistent with our expectation. Although we do not have the raw data to manipulate, we envision an assumption that starts at 9% and declines gradually to the 20th year.
- **P&F:** The first year or two showed very high increases which would be consistent with a probationary period, typical of many public safety groups. We believe the data shows a different pattern of merit increases out to the 10th year.
- **Other Employees in PERS:** This group also shows the higher salary increases in the early years. We believe the observed data may show longevity increases out past the 15th year.



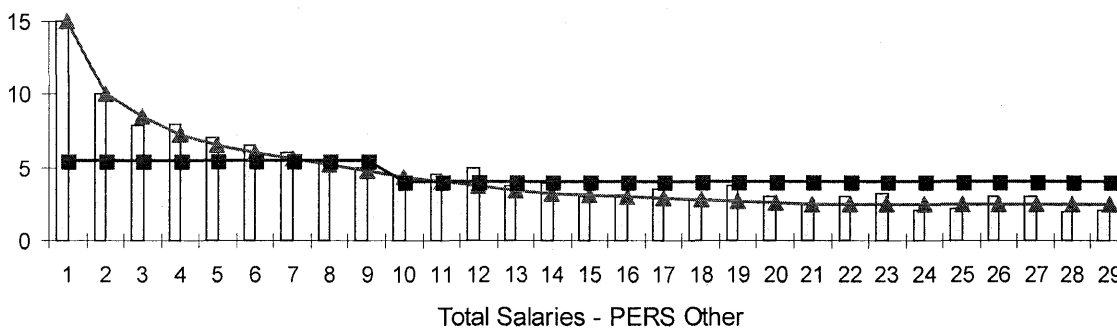
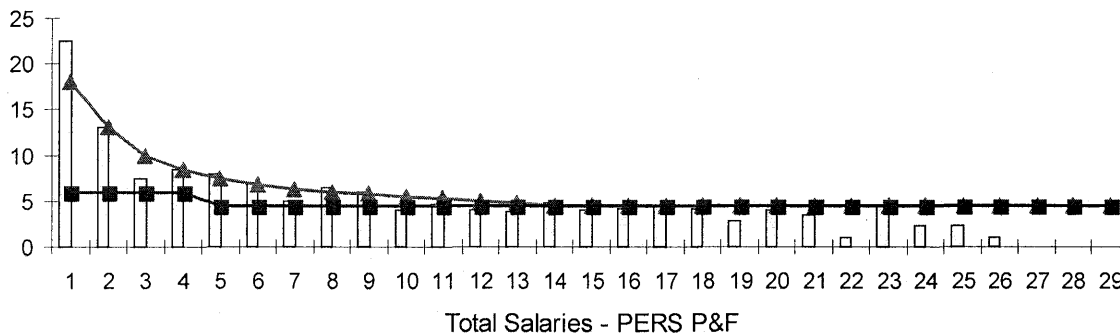
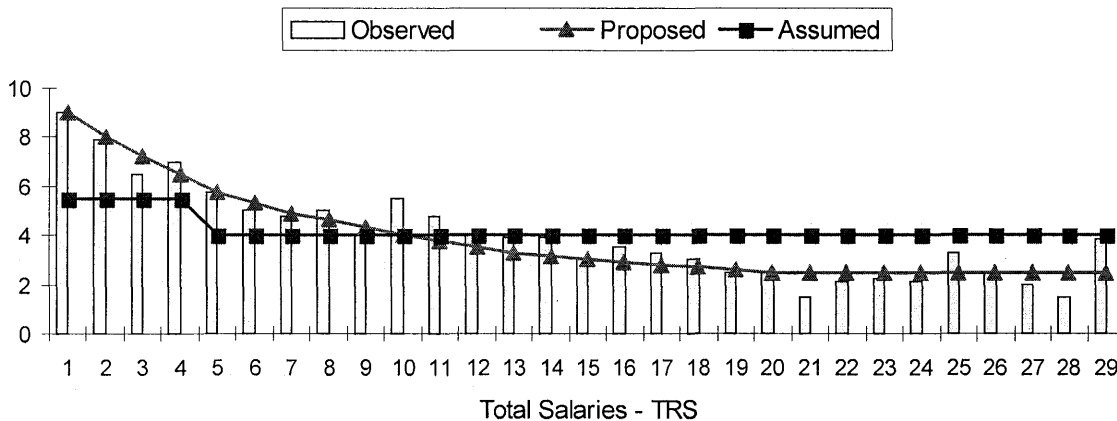
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We have illustrated our observations with a restatement of the graphs from the 2000 Studies (compiled directly from the graphs, not the raw data) and an illustrated proposed set of assumptions. The assumed data is the current assumption used by Mercer.

Note on the following graphs that we have shown the total salary increases, which include inflationary wage growth, if any. The merit increases can only be measured if we know the actual inflationary wage growth for the period. This is usually measured by observing where the total salary increases ultimately level out. Therefore, it is likely that the general wage increases over the observation period were less than the assumed rate, particularly for TRS and the non-P&F PERS members.

Although more study would be needed to arrive at the proper merit increase assumption, the patterns shown as "proposed" on the following graphs may provide a more reliable prediction of future increases.

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Section 5

Valuation Data

Audit Conclusion

The membership data used by Mercer for the June 30, 2001 actuarial valuations of TRS and PERS is consistent with the data provided by the Systems. Mercer's calculation of accrued benefits for vested terminated employees may be overstating benefits and, as a consequence, the valuations may overstate the vested terminated liabilities.

Comments

We compared the data supplied by the TRS and PERS with the data summaries presented in the Mercer valuation report. In order to confirm the accuracy and appropriateness of the data processing performed by Mercer, we received original "raw" data supplied TRS and PERS and proceeded to process this data to create valuation data files. These valuation data files were then used as the basis of a series of data summary exhibits created to compare with the data summary exhibits that appear in the Mercer valuation report.

The Systems provided the following files that served as the basis of our analysis:

- a "master" file containing one record for each active or deferred member in the plan along with necessary demographic data fields,
- a file containing salary and service by year for each active or deferred member in the System,
- a file containing additional claimed service that was not included in the previous two files (TRS only)
- a primary retiree data file derived from the payroll run for all retirees at the end of July, 2001, including the most recent PRPA's.

Member Count: The first step in our verification process was to confirm that the correct number of records were being used. For the active, vested terminated, and retired groups we were able to do this in a precise manner since individual records with unique identifiers were available in the data files supplied by the Systems. Based on our understanding of the data, we constructed a data set that we believe to be an accurate representation of the plan population on June 30, 2001. After summarizing this data set we compared participant counts by participant status (active, vested terminated, retired) to those counts presented in the Mercer valuation report. In summary, for each



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participant status we were able to match the respective participant count that appears in Mercer's reports.

Active Members: The second phase of the data analysis was to verify that the edited data used by Mercer reflected the raw data supplied by the Systems. For the active groups, we were able to create and compare distributions of participants by age, earnings, and credited service with the active data summaries that appear in Mercer's report. Based on these comparisons, we believe that the active data used by Mercer is consistent with the data supplied by TRS and PERS.

In-Pay Status: For the in-pay-status group consisting of service retirees, surviving beneficiaries, and disabilities, we were able to compare average age at commencement, average age at the valuation date, and average monthly benefit amount. For the most part, the Mercer edited data, as summarized in the report, is consistent with the raw data supplied by TRS and PERS.

Vested Terminated: The vested terminated participant group was summarized by average age at valuation date and average deferred benefit. We were able to match the average age of the vested terminated participants; however, we were unable to match the average benefit.

In determining the average deferred benefit for the vested terminated group it was necessary to perform a calculation of the accrued benefit of each vested terminated participant based on the compensation and service histories provided in the raw data. Our calculation produced lower average monthly benefits than the Mercer average for both Systems. Based on discussions with Mercer, it is our understanding that most of this discrepancy is due to the calculation of a vested terminated employee's accrued service. Mercer calculated service as the elapsed number of years between initial hire date and date of termination. This technique will tend to overstate the service of a part-time employee or an employee with a break in service.

We recommend that Mercer review the process of calculated accrued benefits for vested terminated members. Alternatively, the best approach would be for each System to perform the calculations and put the resulting accrued benefits on the member records.

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Section 6

Report Validation

Audit Conclusion

We believe the basic mathematical computations contained in the two actuarial valuation reports were completed accurately. However, there were some calculations shown in the reports we could not verify. In addition, as outlined in Section 1, there are a number of processing adjustments that will need to be made to the technical aspects of both the TRS and PERS valuations.

Comments

We did have difficulty following certain calculations and were not able to verify all mathematical calculations. We recommend that future valuation reports contain more detail regarding the following:

- Amortization of investment return outside the 5% corridor with interest
Section 1.1(c); line (5)
- Outstanding balance of previously deferred amounts outside the corridor
Section 1.1(d); line (5)
- Normal Cost by type of benefit
Section 1.3; line (1)
- Determination of adjustment for Target Unfunded Liability (PERS only)
Section 1.3(c); line (1) of Past Service Rate section
- Application of Actuarial Projections
Section 1.5
- The contribution rates developed in the valuations include an amortization schedule using a projected membership population. Therefore, the recommended contributions do not comply with the parameters permitted for the calculation of the Annual Required Contribution (ARC) under GASB disclosure Statement No. 25. A separate calculation of the ARC is required and it is not shown in the valuation reports. These calculations are not required to be shown in the valuation, but typically are included because the funding calculations and disclosure calculations are so similar. We do not have enough information to validate the GASB calculations.



ALASKA STATE LEGISLATURE

LEGISLATIVE BUDGET AND AUDIT COMMITTEE

Division of Legislative Audit



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January 25, 2006

Members of the Legislative Budget
and Audit Committee:

In accordance with the provisions of Title 24 of the Alaska Statutes, the attached report is submitted for your review.

DEPARTMENTS OF ADMINISTRATION AND REVENUE PUBLIC EMPLOYEES' RETIREMENT SYSTEM, TEACHERS' RETIREMENT SYSTEM, AND ALASKA STATE PENSION INVESTMENT BOARD

SELECTED ISSUES

December 30, 2005

Audit Control Number

02-30037-06

The purpose of this audit was to review and assess the fiscal history of the state-administered Public Employees' Retirement System (PERS) and Teachers' Retirement System (TRS). Both plans currently face significant projected unfunded liabilities. Our primary objective was to review the past decisions made by the PERS board, the TRS board, and the Alaska State Pension Investment Board to assess to what extent, if any, the boards' decisions contributed to the plans' current unfunded liabilities.

The audit was conducted in accordance with generally accepted government audit standards. Fieldwork procedures utilized in the course of developing the findings and discussion presented in this report are discussed in the Objectives, Scope, and Methodology.

A handwritten signature in cursive script that reads "Pat Davidson".

Pat Davidson CPA
Legislative Auditor

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OBJECTIVES, SCOPE, AND METHODOLOGY

In accordance with Title 24 of the Alaska Statutes and a special request by the Legislative Budget and Audit Committee, we have conducted an audit of selected issues related to the Public Employees' Retirement System (PERS) and Teachers' Retirement System (TRS) administered by the Department of Administration (DOA), Division of Retirement and Benefits (DRB). We also reviewed certain actions of the PERS and TRS oversight boards and the Alaska State Pension Investment Board (ASPIB).¹

Objectives

Specific objectives of this audit were:

- To review the legal implications of maintaining underfunded state pension plans.
- To review the fiscal history and current funding status of PERS and TRS (Plans), including determination of the internal and external factors that contributed to the Plans' current underfunded status. To compare the Plans' funded status with other state public pension plans.
- To determine whether the PERS and TRS boards' rate-setting decisions were consistent with their consulting actuary's calculations and advice.
- To ascertain to what extent, if any, the actions of the PERS and TRS oversight boards contributed to the Plans' decline.
- To determine the extent that ASPIB followed their advisors' recommendations in adopting the Plans' asset allocations. Also, to compare the Plans' asset allocations and investment returns to other state public pension plans.
- To review state funding appropriated to participating employers to alleviate recent increases in employer contribution rates.

Scope

The scope of the audit includes varied time periods depending on the audit objective.

- PERS and TRS employer contribution rate decisions – Adopted rates for FY 90 to FY 06 were reviewed for consistency with the consulting actuary's calculations and advice.

¹ All three boards were abolished effective July 1, 2005 and replaced by the Alaska Retirement Management Board, effective October 1, 2005.

- ASPIB asset allocation decisions – Adopted asset allocations for FY 99 to FY 05 were reviewed for consistency with the Treasury staff and investment consultants’ advice.
- PERS and TRS funding ratios – Funding ratios from July 1, 1992 through June 30, 2004 were reviewed to determine the internal and external factors causing the changes in ratios with a focus on the period July 1, 1999 through June 30, 2004.
- Other state public pension plans – Five public employees’ pension plans² and five teachers’ retirement plans³ were selected from 127 public pension plans surveyed by the National Association of State Retirement Administrators (NASRA) in 2004. Our selection was based on similar asset size, covered employee group(s), and plan management type (agent multiple-employer plan or cost-sharing multiple-employer plan) as those of the Plans.

Methodology

We obtained and reviewed the former DRB consulting actuary’s⁴ calculations of changes in funding ratios and funding net shortfalls due to differences between calculated employer rates and adopted rates. In addition, we obtained the annual valuation reports prepared by the former consulting actuary for the Plans. We determined the reasonableness of assumptions and methodologies used in developing the annual actuarial valuation by:

- comparing the inflation factors with the applicable Consumer Price Index,
- making a comparison of the assumed rate of return with other state public pension plans, and
- reviewing actuarial audit reports of the former consulting actuary’s valuation reports.

Although we reviewed the assumptions and methodologies of the calculations for the valuation reports, we did not re-perform them.

We determined the variances between the consulting actuary’s calculated employer contribution rates and the rates adopted by the Plans’ oversight boards and the causes for such variances. The Plans’ asset allocations were analyzed to determine if they were consistent with the advice of ASPIB’s advisors. We compared the Plans’ funding ratios, asset

² Arizona Public Safety Personnel Retirement System, Illinois State Employees’ Retirement System, Louisiana State Employees’ Retirement System, Michigan State Employees’ Retirement System, and Virginia Retirement System. Although much larger than the other plans, Virginia Retirement System was included as part of the audit request.

³ Arkansas Teachers’ Retirement System, Kentucky Teachers’ Retirement System, Montana Teachers’ Retirement System, North Dakota Teachers’ Fund for Retirement, and Oklahoma Teachers’ Retirement System.

⁴ Mercer Human Resource Consulting, LLC was the actuary for both Plans since at least 1976. Available records indicate that the contract was competitively bid in 1986, 1994, and 1999 with Mercer being awarded the contract. In 2005, DRB solicited bids for the contract and awarded it to Buck Consultants, LLC. The contract period is from October 1, 2005 to June 30, 2009, with five one-year renewal options.

allocations, and investment returns with those of the selected ten other state public pension plans as reported by NASRA and the states' financial reports. These comparisons were augmented by reviews of available information on the ten plans' websites and interviews of the plan administrators. Medical cost-saving initiatives of DRB and the Plans' boards were reviewed and discussed with DRB staff.

The following documents were also reviewed:

Laws and Regulations:

- Alaska Statutes including AS 14.25, AS 37.10.210 to 37.10.390, and AS 39.35.
- Regulations including 2 AAC Chapter 35 and 2 AAC Chapter 36.
- Session laws including Chapter 9, FSSLA 2005; Chapter 3, FSSLA 2005; Chapter 159, SLA 2004; Chapter 57, SLA 2001; Chapter 4, FSSLA 1996; Chapter 97, SLA 1990; and Chapter 82, SLA 1986.

Reports and Publications:

- 1993 performance audit by the Division of Legislative Audit of TRS.
- PERS and TRS comprehensive annual financial reports (financial and actuarial sections) for fiscal years 1990 to 2005.
- PERS and TRS actuarial valuation reports for June 30, 1990 to June 30, 2004 and PERS valuation supplements for June 30, 1995 to June 30, 2003.
- *Employee Benefits and Retirement System Funding White Paper*. A 2003 paper authored by DRB Chief Financial Officer.
- *Employers' Edge*. Newsletters published by DRB for calendar years 1998 to 2005.
- *PERS Newsbreak* and *TRS Newsbreak*. Newsletters published by DRB for calendar years 1996 to 2005.
- *Actuarial Audit of State of Alaska TRS & PERS*. A 2002 audit conducted by Milliman USA.
- *Actuarial Audit of the Public Employees' and Teachers' Retirement Systems*. A 1995 audit conducted by A. Foster Higgins & Co., Inc.
- *State of Alaska Public Employees' Retirement System Funded Study Analysis*. A 2005 report prepared by Actuarial Service Company, P.C.
- *Findings and Analysis Regarding Alaska State Pension Investment Board's Investment Program*. A 2003 audit performed by Independent Fiduciary Services, Inc.
- 1991, 1996, and 2000 actuarial assumption studies for PERS and TRS.

- 1994 inflation component of economic assumption study for PERS and TRS.
- *State Government Retiree Health Benefits: Current Status and Potential Impact of New Accounting Standards*. A 2004 report prepared by Workplace Economics for the American Association of Retired Persons.
- *Public Fund Survey Summary of Findings for FY 2004*. A report prepared by NASRA.

Other Documents:

- Relevant PERS board, TRS board, and ASPIB minutes and resolutions.
- DRB director correspondence files for calendar years 1997 to 2005.
- Pertinent correspondence between DRB and Mercer Human Resource Consulting, LLC; Milliman USA; and Deloitte Consulting, LLP for calendar years 2001 to 2005.
- ASPIB Investment Policy and Procedure Manual.
- Relevant legislative committee minutes.
- 2003 and 2004 public fund surveys conducted by NASRA and National Council on Teacher Retirement.
- Financial statements and websites of other state pension plans.
- Department of Law legal representation letters to the Plans' public accounting firm for the FY 05 financial audit.
- DRB reports regarding appeals to the court from 1997 to April 2005 of the Plans' administrative board decisions and related Alaska Supreme Court opinions.
- Other DRB documents concerning the Plans.

We also interviewed the following individuals:

- DOA and DOR deputy commissioners, DRB director and staff, and Treasury Division staff.
- Former board members.
- The Plans' former consulting actuary.
- DRB's lead assistant attorney general and the Plans' board attorney.
- Plan administrators of other state public pension plans.

ORGANIZATION AND FUNCTION

Public Employees' Retirement System

Established in 1961 under AS 39.35.010, the Public Employees' Retirement System (PERS) was created to provide "*for the payment of retirement, disability, and death benefits to or on behalf of*" employees of the State, political subdivisions, and public organizations.⁵ Many school districts and the University of Alaska (UA) also participate in PERS to provide benefits to personnel without academic standing.

PERS is administered by the Department of Administration (DOA), Division of Retirement and Benefits (DRB). The delegated plan administrator⁶ is responsible for managing the accounts of employer and employee contributions and the payment of benefits to retirees and beneficiaries. PERS is a defined benefit plan, paying benefits based on a formula set in law, rather than the retiree's account balance. Currently, there are three tiers of benefits under PERS. (See Appendix A) However, SB 141 (Chapter 9, FSSLA 2005) created a defined contribution plan, adding a fourth tier to PERS effective July 1, 2006.

As an agent multiple-employer plan, PERS is essentially an aggregate of single-employer plans that pools assets and shares administrative costs, but maintains separate liabilities. A contribution rate is calculated for each employer. In addition to the State, currently there are 159 political subdivisions and public organizations that participate in the plan. As of June 30, 2005, there were 73,725 PERS participants: 33,732 active members; 20,703 retirees and beneficiaries; 6,517 vested terminations; and 12,773 non-vested terminations with account balances.

Teachers' Retirement System

The Teachers' Retirement System (TRS) was established in 1955 under AS 14.25.010, effective July 1, 1955, to provide "*for the payment of retirement, disability, and death benefits to or on behalf of*" certified teachers, university teaching staff, and other employees with academic standing in the State.

As with PERS, TRS is administered by DRB with the delegated plan administrator managing the accounts of employer and employee contributions and the payment of benefits to retirees and beneficiaries. Also like PERS, TRS is a defined benefit plan, providing formula-driven,

⁵ The term public organization refers to government-affiliated entities such as the Alaska Housing Finance Corporation, the Anchorage Parking Authority, and the Cook Inlet Housing Authority.

⁶ The delegated plan administrator is the director of DRB.

lifetime payments to the retiree or beneficiary. Currently, there are two tiers of benefits under TRS. (See Appendix B) However, Chapter 9, FSSLA 2005 also created a defined contribution plan for TRS, adding a third tier effective July 1, 2006.

In contrast to PERS, TRS is a cost-sharing, multiple-employer plan, under which multiple employers share assets, costs, and liabilities. All employers pay the same employer contribution rate. School districts, UA, regional resource centers, and the State participate in TRS. Currently, there are 58 employers participating in TRS. As of June 30, 2005, there were 22,323 TRS participants: 9,786 active members; 9,018 retirees and beneficiaries; 750 vested terminations; and 2,769 non-vested terminations with account balances.

PERS Board

Organizationally under DOA, the PERS board provided regulatory and technical oversight of PERS until the board was abolished effective July 1, 2005. The powers and duties of the board included adopting PERS regulations and resolutions, acting as an appeals board, setting the employer contribution rate based on an actuarial valuation, and other duties enumerated under state law (AS 39.35.040). The board was composed of two PERS members elected by the PERS membership and three public members appointed by the governor. For the sole purpose of hearing disability benefit appeals, the board included two governor-appointed, state-certified physicians and two alternates.

TRS Board

The TRS board provided regulatory and technical oversight of TRS under DOA until the board was abolished effective July 1, 2005. The powers and duties of the board included adopting TRS regulations and resolutions, acting as an appeals board, recommending to the plan administrator⁷ the employer contribution rate based on an actuarial valuation, and other duties enumerated under state law (AS 14.25.035). The board was composed of five members appointed by the governor, at least one of whom was a state resident receiving TRS benefits. For the sole purpose of hearing disability benefit appeals, the board included two governor-appointed, state-certified physicians and two alternates.

⁷ Prior to October 2005, the employer contribution rates for PERS were set annually by its oversight board. In contrast, the TRS oversight board's authority was not as extensive – the board could recommend what the rates should be for employers; however, the final authority rested with DOA. This notwithstanding, the TRS board, rather than the commissioner, traditionally set the employer contribution rates. Under recently revised legislation, the newly constituted Alaska Retirement Management Board sets employer contribution rates for both PERS and TRS defined benefit plans.

Alaska State Pension Investment Board

In 1993, state law (AS 37.10.210) established the Alaska State Pension Investment Board (ASPIB) within the Department of Revenue (DOR). Assuming the fiduciary role previously held by the commissioner of DOR, ASPIB was responsible for the prudent management and investment of state pension plan assets until it was abolished July 1, 2005.

ASPIB's powers and duties included establishing investment policies, selecting and retaining the funds' external investment managers, reviewing and reporting on the funds' performance, meeting annually with the PERS and TRS boards, and other duties enumerated under state law (AS 37.10.220).

The board was composed of eight trustees: two PERS members elected by the PERS membership, two TRS members elected by the TRS membership, three governor-appointed trustees, and the commissioner of DOR. The board had three investment advisors: a contracted external investment consultant, the board-appointed investment advisory council, and DOR, Division of Treasury staff.

Alaska Retirement Management Board

Established under Chapter 9, FSSLA 2005, the Alaska Retirement Management Board (ARMB) replaced the PERS and TRS boards, and ASPIB, assuming oversight and management of the retirement funds, effective October 1, 2005. Organizationally in DOR and staffed by the Division of Treasury, ARMB is composed of nine trustees appointed by the governor: a finance officer, two members of the general public, two trustees selected from four PERS bargaining unit nominees, two trustees selected from four TRS bargaining unit nominees, and the commissioners of DOA and DOR. Like ASPIB, ARMB has an external investment consultant and an investment advisory council.

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BACKGROUND INFORMATION

Retirement plans can be divided into two broad classifications – defined benefit plans and defined contribution plans. A defined benefit plan pays an eligible participant benefits determined by an established formula. These benefits are not necessarily tied to, or limited by, the financial contributions made into the plan by a given participant and the participant’s employer(s). By contrast, a defined contribution plan bases payments on the financial contributions made on behalf of or by each participant: the more money individuals have credited to their accounts, the more in benefit payments they can expect to receive.

State administered retirement programs have historically been defined benefit plans

Historically, both the Public Employees’ Retirement System (PERS) and the Teachers’ Retirement System (TRS) have been defined benefit pension plans⁸ (Plans). The calculation of benefits paid under each Plan is set in state law. State law also sets what percentage of income each participating employee is to pay into the Plans. The amount paid by participating employers is based on rates that are either set, or recommended, by the Plans’ oversight boards.

Funding rates for employers are based on an annual assessment of each Plan’s liabilities

PERS and TRS have three sources of revenue: contributions from employee participants, contributions from participating employers, and return on investments of the Plans’ assets. The employee contribution rate is set in state law, while the return on investments is determined by investment strategy and market conditions. The primary factor controlled by the respective plan oversight boards is the employer contribution rate.

Each year both Plans’ oversight boards receive an assessment, termed a “valuation,” from a consulting actuarial firm. This annual valuation assesses the prospective liability stemming from the projected cost of each Plan’s defined benefits. The valuation plays a central role in the rates charged to employers who participate in TRS and PERS. The actuary’s calculated rate serves as the primary guideline used by each oversight board in setting employer rates.

In estimating the liabilities of each Plan, the actuary makes informed assumptions about demographic and economic variables, such as investment return, salary increases, mortality rates for participants, and the likely increase in medical costs. The valuation projects how much each participating employer should contribute in order for the Plan to meet prospective

⁸ Effective for new hires on or after July 1, 2006 under both Plans, employees will be under a defined contribution plan.

benefit payment liabilities. The valuation estimates how much each employer should contribute, in terms of the percentage of their employees' payroll, in order to fund the associated benefit obligation.

Projected rates are made up of two parts – past service costs and current “normal” costs

When determining what rates are necessary to meet liabilities, the actuary calculates two separate costs:

1. Past service costs. These are costs for each employer that have carried over from past assessments. Typically, they stem from situations where the established contribution rate proves not to be high enough to cover the costs of benefits or where there is an increase in benefits for retiree participants (who are no longer paying into the system) or where the new participants are allowed to purchase past service years from a prior position with a nonparticipating employer. The past service rate is the part of the overall rate dedicated to covering any accumulated, unfunded liability.
2. Current or “normal” costs. This element represents each participating employer's cost of benefits earned by active members during the current plan year.

The actuary applies these cost factors differently when calculating the rate each participating employer should pay. The Plans differ as follows:

1. PERS employers pay an “individual” cost rate. All employers pay the same rate to cover normal costs, but pay a specific past-service cost rate reflecting the costs associated with their retired beneficiaries. Accordingly, employers participating in PERS pay differing blended rates. For FY 06, the highest calculated rate was 110.24 percent, the lowest was zero percent,⁹ with the average being 25.63 percent.
2. TRS employers all pay the same rate. TRS has one employer contribution rate that consists of one rate to cover normal costs and past service costs for all employers. For FY 06, the calculated employer contribution rate was 38.85 percent.

Past legislative action to decrease pension costs was diminished by later legislation

In an effort to lower pension and medical benefit costs, the legislature created a PERS Tier II in 1986¹⁰ for employees first hired after June 30, 1986 and a Tier III in 1996¹¹ for employees first hired after June 30, 1996.

⁹ A zero contribution rate occurs when the employer's assets exceed the liabilities by an amount that is equal to or greater than the employer's normal cost.

¹⁰ Chapter 82, SLA 1986.

¹¹ Chapter 4, FSSLA 1996.

PERS Tier II increased the normal retirement age from 55 years to 60 years of age and the early retirement age from 50 years to 55 years of age. These actions decreased future pension benefit payments by delaying the age of retirement. In addition, Tier II lowered retiree medical coverage costs by requiring a retiree under the age of 60 years to pay the full premium and retirees 60 years old but under 65 years to pay one-half the premium for the benefit. (Prior to Tier II, all retirees received medical coverage with full system-paid premiums.)

Tier III further restricted system-paid medical premiums for retirees by requiring them to have at least ten years credited service to be eligible for the benefit. Other changes were made that had the effect of increasing or decreasing retiree pension costs.

Then in 1990, the legislature created a TRS Tier II for employees first hired after June 30, 1990.¹² As with PERS Tier II, the 1990 legislation¹³ lowered retiree medical coverage costs by requiring a retiree under the age of 60 years to pay the full premium and retirees 60 years old but under 65 years to pay one-half the premium for the benefit.¹⁴ The legislation also made other changes affecting the retiree pension costs.

With the enactment of Chapter 57, SLA 2001, more retirees who were first hired on or after July 1, 1986 for PERS or July 1, 1990 for TRS received system-paid premiums by lowering the age requirements. (See Appendix A and B for additional details concerning these legislative changes to both Plans)

In addition, while retiree costs have been on the rise and employer contributions have increased, the participants' contributions have remained the same for PERS since 1987 and for TRS since 1991.

Funding ratio provides measure of each Plan's solvency

The oversight boards consider the Plans' funding ratios when setting employer contribution rates. The funding ratio is the ratio of assets to projected liabilities of the fund as determined by the actuarial valuation. It is a measure of the pension plan's financial condition. When the estimated future assets of the fund exceed the projected liabilities, the funding ratio is above 100 percent. When projected accrued liabilities exceed estimated future assets, the funding

¹² Chapter 97, SLA 1990.

¹³ Due to the Alaska Constitution, Article XII, Section 7 requirement to not "*diminish or impair*" benefits of previously hired and employed participants, various "tiers" of public employees have been established. These tiers are based on the hire date of the employees in order to change ages for retirement, periods necessary for vesting, post-employment medical eligibility, etc.

¹⁴ Prior to the establishment of TRS Tier II, like PERS, retirees received system-paid premium medical coverage.

Exhibit 1

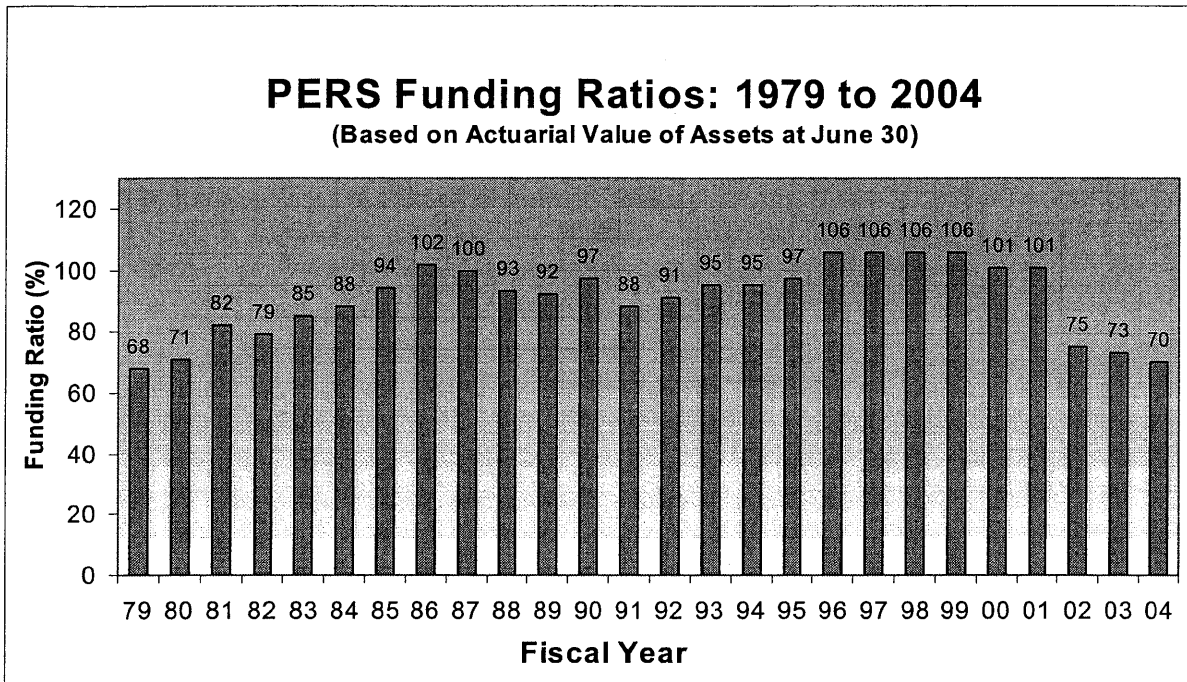
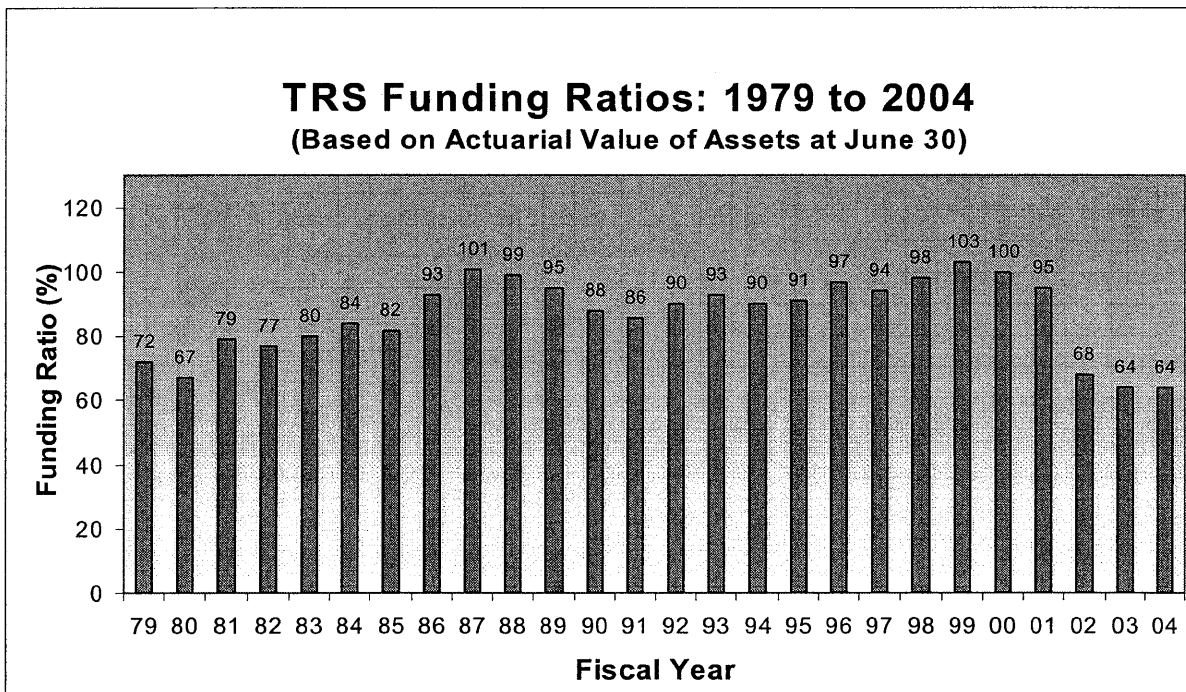


Exhibit 2



ratio falls below 100 percent. This difference between the accrued liabilities and the assets represents what is termed the plan's unfunded actuarial accrued liability.

From FY 01 to FY 02, both Plans experienced dramatic declines in their funding ratios. The PERS' funding ratio dropped from 101 percent to 75 percent and was most recently calculated to be 70 percent. Over the same period, the ratio for TRS declined from 95 percent to 68 percent, currently sitting at 63 percent.¹⁵ The current funding ratios are similar to the ones experienced in FY 79 when PERS was funded at 68 percent and TRS was funded at 72 percent. (See Exhibit 1¹⁶ and Exhibit 2¹⁷ on the opposite page)

Retiree healthcare is administered by the State through self-insurance program

Beginning in FY 98, the State opted to provide health care benefits to retirees through self-insurance. The State created a separate trust fund, labeled the Retiree Health Fund (RHF), to keep track of funding and expenditures. RHF was designed to provide funding necessary to meet current and future medical costs for retirees.¹⁸

Each month the premium for each retiree's health care benefits¹⁹ is transferred from PERS and TRS to RHF. The amount of the premiums is based on consultant calculations that try to anticipate future claims and the estimated administrative costs. Besides these premium transfers, RHF is also credited with the investment earnings generated by any balance of transferred funds.

During FY 04, DOA determined that RHF had an excess balance.²⁰ A \$20 million transfer was made from RHF back to the state's retirement systems.²¹ Since the retirement plans have a potential for a higher rate of return on investments than RHF, DOA management believed it was prudent to transfer the funds back to the respective retirement plan. Such reviews of fund balances are done periodically to determine that the RHF reserves are adequate, but not

¹⁵ As of the most recent valuation report dated June 30, 2004.

¹⁶ Mercer Human Resource Consulting, LLC, *State of Alaska Public Employees' Retirement System Actuarial Valuation Report as of June 30, 2004 As Approved by the Alaska Retirement Management Board on October 12, 2005*, p. 2.

¹⁷ Mercer Human Resource Consulting, LLC, *State of Alaska Teachers' Retirement System Actuarial Valuation Report as of June 30, 2004 As Approved by the Alaska Retirement Management Board on October 12, 2005*, p. 2.

¹⁸ Major medical plan (premiums mostly paid by funds transferred from the respective retirement fund), the dental-vision-audio (DVA) plan, and the long-term care (LTC) plan (premiums for both of the latter are paid for, fully, by the retiree).

¹⁹ The medical premium for calendar year 2006 has been calculated at \$875, up from \$850 for 2005.

²⁰ Excess reserves are the result of a number of factors, such as, claim experience was less than anticipated, more generic prescriptions were purchased lowering the Plans' drug costs, higher utilization of in-network providers with negotiated reduced cost, etc.

²¹ PERS received \$13.7 million, TRS received \$6.2 million, the Judicial Retirement System received \$50,000, and the Elected Public Officials Retirement System received \$26 thousand.

excessive. DRB is considering a similar transfer during FY 06 based on the *State of Alaska, 2006 Retiree Benefits Renewal Report, October 31, 2005*.

New Medicare Part D prescription program will reduce costs of the Plans

Medicare Part D is the new prescription drug plan offered to eligible Medicare beneficiaries beginning in 2006. However, the prescription drug benefits offered under both the PERS and TRS plans are better than the benefits offered under Medicare Part D. Therefore, retirees are encouraged not to enroll in Medicare Part D; in order to avoid incurring any unnecessary premium and deductible costs. The Medicare Part D program still pays for some of the prescription drugs purchased by retirees through a direct subsidy to the Plans. The total annual subsidy for both Plans is estimated to be approximately \$7 million. These funds will be deposited into RHF to offset retiree medical coverage costs.

REPORT CONCLUSIONS

We were directed to review and assess the fiscal history of the Public Employees' Retirement System (PERS), the Teachers' Retirement System (TRS) (Plans). Both Plans are facing significant, projected, unfunded liabilities. Our primary objective was to review the past decisions made by each of the Plans' oversight boards and the Alaska State Pension Investment Board (ASPIB)²² and to assess to what extent, if any, the boards' decisions contributed to the current unfunded liability for each Plan.

As discussed further in this section, we have developed the following conclusions:

- It is unclear if state law mandates that retirement funds maintain funding ratios of 100 percent.
- Decreases in funding ratios were primarily due to investment losses and rising medical costs.
- Rate-setting decisions had a small impact on each Plan's declining funding ratios. In three instances, the PERS board set rates below the consulting actuary's calculated rates.
- TRS did not adopt the annual actuarially-calculated employer contribution rate, but rather set a level rate as recommended by the consulting actuary.
- Administrative decisions of oversight boards had limited impact on the Plans' liabilities.
- Regulations with financial effect need to be updated.
- Asset allocations were more conservative, but investment returns were consistent with those of comparable retirement plans in other states.
- An administrative two-year lag between determining the contribution rates and using them has contributed slightly to the Plans' declining funding ratios.
- Recent state appropriations partially offset higher contribution rates faced by participating employers.

²² The Alaska Retirement Management Board replaced the Plans' boards and ASPIB on October 1, 2005.

It is unclear if state law mandates retirement funds maintain funding ratios of 100 percent

Policy decisions related to the administration of retirement plans for public employees are, and have been, shaped by Alaska's constitution. Article XII, Section 7 prohibits accrued benefits from being "*diminished or impaired.*"²³ It has been suggested that when funding ratios for PERS and TRS fall below 100 percent, the accrued benefits of participants have been diminished or impaired. From our reading of the legal analysis provided to date, absent any specific ruling from the state courts, we do not believe maintaining the funding ratio at this target level is necessarily required.

In 1992, the Department of Law (DOLaw) addressed an inquiry as to whether the governor is constitutionally or statutorily mandated to include employer contributions in the budget to keep the retirement funds actuarially sound. DOLaw noted that while the state Supreme Court had not specifically addressed the issue, there was a

*...strong probability that the Alaska courts would find a diversion of retirement funds to be violative of the Alaska constitution and would in addition find the governor bound by statute to include employer contributions in his budget.*²⁴

DOLaw summarizes its perspective in the 1992 memorandum with the comment that it was likely "*...an Alaska court would hold that **adequate funding** of the state retirement funds is constitutionally required...*" [Emphasis added] Further, in a 2005 memorandum of advice, DOLaw more explicitly comments that "*State law requires employer contribution rates be calculated in amounts sufficient, when combined with employee contributions, **'to provide the benefits earned'***" [Emphasis added]

Not specifically addressed by these analyses is whether allowing the funds to fall below a 100 percent funding ratio amounts to, either, inadequate funding or a situation that deprives participants of earned benefits. In the context of these analyses, we believe the retirement oversight boards have a responsibility to set employer contribution rates and take other actions to maintain the actuarial soundness of each retirement Plan. Optimally, maintaining the funding ratios at or above 100 percent maximizes actuarial soundness.

Accordingly, it would seem that at a minimum, contribution rates should not be lowered when the actuarial valuation indicates that rates should be increased. However, under the

²³ As discussed in Background Information, because of this requirement, new "tiers" of employees have had to be created whenever retirement benefits have been restructured to be less generous. The restructured, lesser benefits involved with each new classification tier are applied to all employees first hired after a specified date by participating employers.

²⁴ In the memorandum, the DOLaw adds that it is also addressing the issue as to whether the legislature is "*...constitutionally mandated to appropriate, those employer contributions that are prescribed by the boards of the various retirement systems to keep the system funds actuarially sound.*"

existing legal interpretation and advice, it does not appear, at least in the short term, the oversight boards must necessarily set rates at such a level as to make it fiscally impractical for employers to participate.

Decreases in funding ratios were primarily due to investment losses and rising medical costs

Between FY 00 and FY 04, the unfunded actuarial accrued liabilities (UAAL) increased to approximately \$3.4 billion and \$2.3 billion for PERS and TRS, respectively. Based on an analysis prepared by the Plans' actuary,²⁵ updated to include FY 04, the following factors affected the UAAL for each Plan.

PERS's actuarial funding ratio declined from 106 percent to 70 percent. Investment losses accounted for about a third of the decline. Changes in participants' death rate assumption,²⁶ medical premiums, and legislative expansion²⁷ of system-paid medical benefits for Tier II and Tier III participants accounted for about a quarter of the decline. Just over a quarter of the drop (28 percent) was attributable to the change in the asset valuation method adopted in 2002.²⁸ The remaining 14 percent of the decline was due to actual Plan experiences related to the participant population, adoption of new economic and demographic assumptions, and two ad hoc post-retirement pension adjustments (PRPAs)²⁹ approved by the PERS board.

During the same period, TRS' actuarial funding ratio declined from 103 percent to 63 percent. Investment losses accounted for about 28 percent of the decline. Changes in participants' death rate assumption, medical premiums, and legislative expansion of system-paid medical benefits, for Tier II participants, accounted for approximately another 12 percent. About 40 percent of the decline was attributable to the change in the asset valuation method adopted in 2002. The remaining 20 percent of the decline was due to actual Plan experiences related to the participant population, data corrections on participants, adoption of new economic and demographic assumptions, and three ad hoc PRPAs approved

²⁵ The former actuary, Mercer Human Resource Consulting, LLC, prepared a letter to the director of the Division of Retirement and Benefits, dated January 23, 2005. The letter delineates the causes of changes in the UAAL from July 1, 1992 to June 30, 2003, using the fiscal year-end market values of net assets.

²⁶ The 1984 Unisex Pension Mortality Table was replaced with the 1994 Group Annuity Mortality Basic Table, resulting in increased estimated lives for participants to accrue and receive retirement plan benefits.

²⁷ Chapter 57, SLA 2001 for both PERS and TRS.

²⁸ As a result of the actuarial audit performed in 2002, effective June 30, 2002, both Plans' boards adopted an asset valuation method that recognizes 20 percent of the investment gain or loss in each of the current and preceding four years. Previously, gains or losses were recognized under the "corridor" method. The actuarial value of assets, as of June 30, 2002, was written down to market value in conjunction with the valuation methodology change.

²⁹ Since 1986 for PERS and 1990 for TRS, the Plans provide for an automatic actuarially-funded PRPA based on the *Consumer Price Index for Urban Wage Earners and Clerical Workers* in Anchorage. Those retirees who were first hired before 1986 for PERS and 1990 for TRS may receive either the automatic PRPA or an ad hoc PRPA approved by the PERS board or the commissioner of the Department of Administration, in the case of TRS. The qualifying retiree receives the PRPA that is greater in value.

Exhibit 3

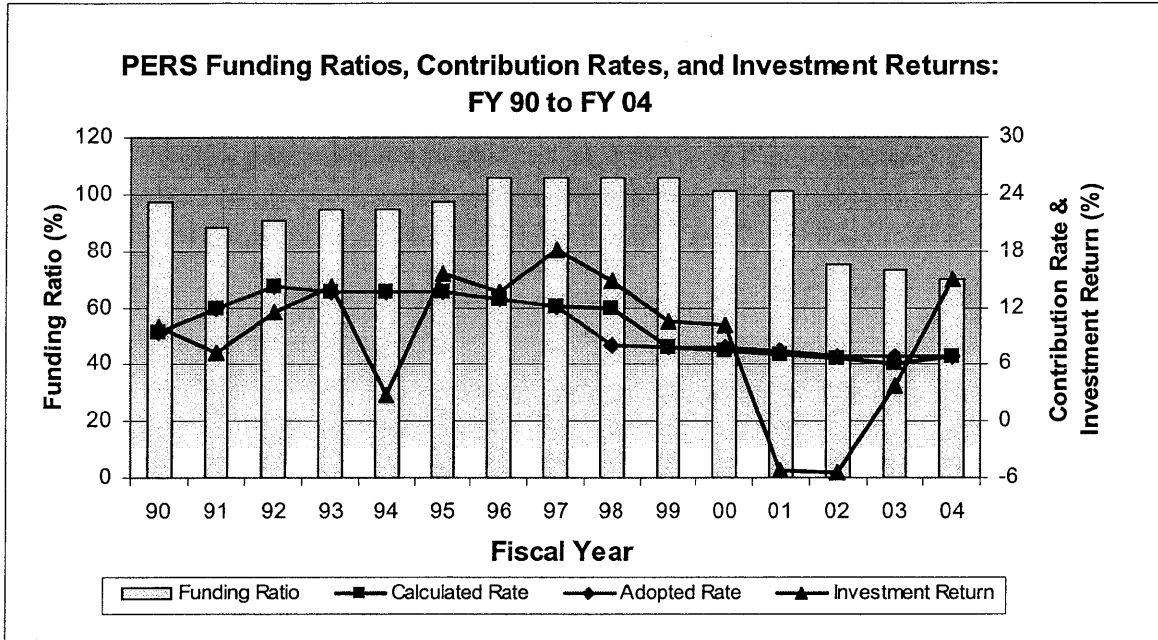


Exhibit 4

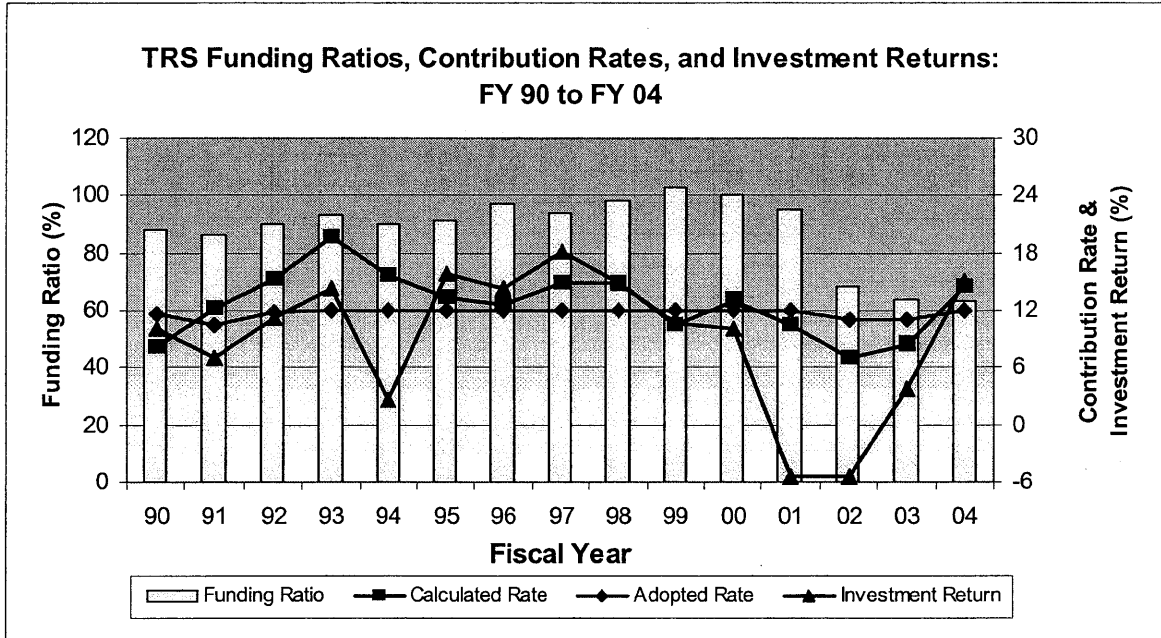


Exhibit 5

by the TRS board. For both TRS and PERS, the apparent over-funding in FY 04 of the state RHF self-insurance account had an immaterial impact on each of the Plans' diminishing funding ratios.

Exhibits 3 and 4 on the opposite page show the funding ratios, employer contribution rates, and investment returns of each Plan for fiscal years 1990 through 2004. They illustrate how the 2001 and 2002 downturn in the stock market resulted in a drastic drop in investment returns. This drop and the recognition of all net investment losses as of June 30, 2002 were the main factors in the decline in the funding ratios.

Both Plans also experienced significant increases in retiree medical costs that contributed to the decline in the funding ratios. The DRB director and both Plans' boards have worked to identify ways to reduce retiree medical costs. (See Exhibit 5)

We compared PERS and TRS funding ratios, with ten (five for each category) other state plans generally of similar asset size. Since these other state plans fund medical benefits on a "pay-as-you-go" basis we have excluded, for PERS and TRS, any medical-benefit related assets or liabilities.³⁰ Exhibit 6 on the next page shows the results of the comparisons.

The State's lower funding ratios, in large part, result from Alaska's PERS and TRS recognizing all the net investment losses at the end of FY 02. By contrast, the other states are spreading those investment losses over multiple years. As discussed earlier, the recognition of those investment losses by PERS and TRS contributed significantly to the funding ratio dropping below 100 percent.

Division and Boards Take Action to Contain Retiree Medical Costs

Rising at rates higher than wage growth and inflation, the cost of medical care is a major driver in the funding ratios' decline. To reduce such costs, the division and boards have taken various measures. Some of these initiatives, and their actual or potential savings according to management and consultants, include:

Positive Open Enrollment – Identification of individuals ineligible for medical benefits is projected to save \$16 million annually.

Generic Prescription Drugs – Since its inception, the generic drug education program has increased generic drug use by approximately 11 percent. A one percent increase in use equals approximately \$1.2 million savings annually.

Medicare Part D – Encouraging eligible retirees, who already have comprehensive drug coverage under AlaskaCare, to not enroll in the new federal drug program is expected to result in an annual estimated federal subsidy of \$7 million.

³⁰ According to a report published by the American Association of Retired Persons (AARP) Public Policy Institute, of the 41 states that reported providing some retiree health insurance, Alaska was one of only 11 that pre-funded such benefits. Other states may provide medical benefits, but fund them on an annual basis, referred to as a "pay-as-you-go" basis. (Stan Wisniewski, Ph.D. J.D. and Lorel Wisniewski, Ph.D., Workplace Economics, Inc., *State Government Retiree Health Benefits: Current Status and Potential Impact of New Accounting Standards*, AARP Public Policy Institute, Washington, DC, July 2004.)

As seen in Exhibit 6, the average drop in funding ratios between FY 02 and FY 04 for the states in the PERS comparison group was over 11 percent and almost 8 percent for the TRS comparison group. In contrast, the drop in Alaska's funding ratio for PERS was less than 1 percent while for TRS it was less than 2 percent. Because these other states are spreading their investment losses into subsequent years those losses will continue to have a negative effect on the funding ratios into the future. (See Appendix C and D³¹)

Rate-setting decisions had a small impact on each Plan's declining funding ratios

- In three instances, the PERS board set rates below actuary's calculated rates

Exhibit 6

Funding Ratios (%)		
Plan	FY 02	FY 04
PERS Comparison Group		
Arizona	113.0	92.4
Virginia	101.8	90.3
Michigan	98.7	84.5
Alaska – PERS*	86.8	86.0
Louisiana	70.2	59.3
Illinois	53.7	54.2
TRS Comparison Group		
Arkansas	91.9	83.8
North Dakota	91.6	80.3
Kentucky	86.6	80.9
Montana	83.4	74.0
Alaska – TRS*	75.4	73.8
Oklahoma	51.4	47.3
* excludes medical benefit related assets and liabilities		

For the 17-year period from FY 90 through FY 06, the PERS board set employer contribution rates equal to or slightly higher than the actuary's calculated rates, with three exceptions. The FY 98 and more recently the FY 05 and 06 rates were set below those calculated by the actuary, although for different reasons. (See Exhibit 7)

For FY 98, the PERS board initially adopted the calculated rate of 11.90 percent and then lowered it to 8 percent the following year.³² At the time, PERS had a projected funding ratio of 106 percent and the board saw lowering the rate as a way to reduce volatility in the rates.³³ In making their decision, the board sought and followed the advice of their consulting actuary.³⁴

This action contributed minimally to PERS' underfunded status. Lowering the FY 98 rate resulted in a shortfall of approximately \$56 million as of June 30, 2003. This shortfall was partially offset by the board's adoption of rates slightly higher than the actuarial rates four times – FY 00 through FY 03.

³¹ The Illinois State Employees Retirement System and the Kentucky Teachers' Retirement System were not included in the Appendix because the additional information was not readily available.

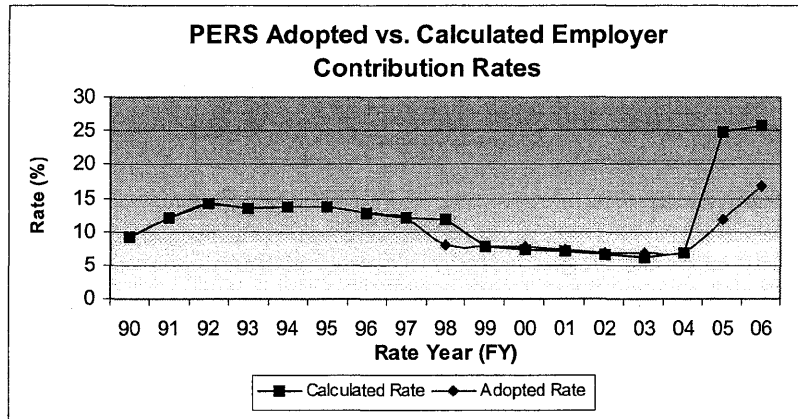
³² Although the PERS board decreased the employer contribution rate for FY 98 in FY 99, due to the budget process requiring approval by the legislature or the respective local government oversight body, it would have been difficult to increase the rate after it had been adopted by the PERS board and the employers had included it in their approved budget.

³³ Without the reduction, the contribution rates would have been 11.90 percent in FY 98, falling sharply to 4.30 percent in FY 99, and rising to 7.74 percent in FY 00. Lowering the FY 98 rate smoothed the contributions to 8 percent, 7.74 percent, and 7.74 percent.

³⁴ According to the former consulting actuary, lowering the rate was "preferable" to keeping it at 11.90 percent (March 20-21, 1997 PERS Spring Board Meeting minutes).

These higher rates represented an increase in the fund of \$21 million as of June 30, 2003 with a net effect of a \$35 million shortfall, or 0.2 percent decline, in funded status as of June 30, 2003.³⁵

Exhibit 7



As reflected by the graph in Exhibit 7, the calculated employer rates rose dramatically after FY 04. The PERS board responded

by substantially increasing the adopted employer rate, going from 6.77 to 11.77 percent for FY 05 and on to 16.77 percent for FY 06. While the increases represented more than a doubling over the two years, the calculated rate was approximately 25 percent each year. Although considerably less than the calculated rate, the rates adopted for both years were the maximum allowed by regulation.³⁶

- TRS did not adopt the annual actuarially calculated employer contribution, instead a level rate was set as recommended by the consulting actuary

The PERS and TRS boards historically employed different strategies in adopting annual employer contribution rates. The PERS board typically adopted rates equal to or slightly higher than the actuary's calculated rate, subject to the annual five percent regulatory restriction. In contrast, until recent years, the TRS board sought to maintain a level, long-term contribution rate of 12 percent for participating employers.³⁷ Such a strategy resulted in the board often adopting rates lower than the actuarial calculated rates.

This approach was endorsed by the TRS Plan's actuary.³⁸ In 1991, the consulting actuary stated,

³⁵ This analysis was provided to DRB by Mercer in a memo dated February 14, 2005.

³⁶ Regulation 2 AAC 35.900, effective May 17, 1991, states: "The maximum change in the contribution rate for an employer from one year to the next shall be no more than five percentage points, as actuarially calculated, whether the change is an increase or a decrease." Enactment of Chapter 9, FSSLA 2005 preempted this regulation.

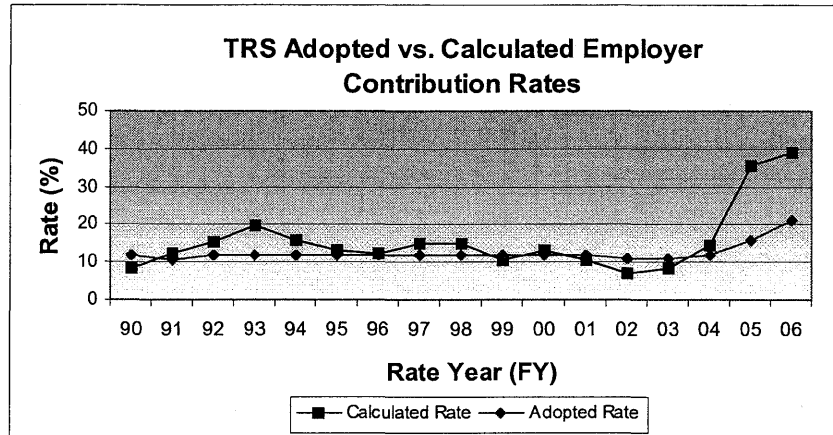
³⁷ The TRS board adopted this strategy in 1991 for rate years beginning with FY 93. Prior to this, TRS' policy was to adjust contribution rates for plan changes (e.g. new legislation, ad hoc PRPAs) that occurred during the two-year period between rate adoption and rate implementation. This former practice resulted in "actual" contribution rates, differing from "actuarial" contribution rates, as reflected by the FY 90 through FY 92 rates in Exhibit 8.

³⁸ Beginning with the July 1, 1991 valuation report through the June 30, 1998 report, the consulting actuary explicitly recommended the level contribution rate of 12 percent for FY 94 through FY 01. Then, in the June 30, 1999 valuation report the 11 percent rate for FY 02 was explicitly recommended by the consulting actuary.

We are proposing to the Board that sound actuarial principles would support leveling out this [employer] contribution pattern to anticipate the second tier provisions coming into effect. In this way, a more stable contribution pattern could be adopted to help State and school districts better budget retirement expenses.

Exhibit 8

For most years between FY 93 through FY 04, the TRS board maintained the contribution rate at 12 percent.³⁹ Although the board had no restriction on how much it could change rates, the board opted to limit the increase for FY 05 to 4 percent (raising the total contribution rate to 16 percent) and for FY 06 to 5 percent (making the employer contribution rate 21 percent).



As reflected by the graph in Exhibit 8, above, the actuarial calculated rate for those years exceeded 35 percent. As such, the FY 05 and FY 06 adopted rates covered the Plan's normal cost projections, with only one-tenth and one-third of the rate contributing to the unfunded liability in FY 05 and FY 06, respectively.

For the 14 years between FY 90 through FY 03, the TRS board adopted rates lower than the actuary's calculated rates nine times. Such action resulted in an accumulated shortfall of approximately \$242 million. Conversely, the board adopted rates above the calculated rates five times, resulting in an accumulated surplus of \$97 million. The net effect was a \$145 million shortfall as of June 30, 2003 or 2.5 percent decline in the Plan's funding ratio.⁴⁰

While the TRS board's level-rate strategy contributed more to the decline in the Plan's funding ratio than the PERS' board policy, neither board's rate-setting decisions – for years prior to FY 05 – played a major role in each Plan's declining ratios.

³⁹ As of June 30, 1999 and 2000, the funding ratio had risen to 103 percent and 100 percent and the calculated rates for FY 02 and FY 03 had fallen to 7.09 percent and 8.29 percent, respectively. Given the Plan's healthy status and the significantly lower calculated rates, the board lowered the adopted rates for FY 02 and FY 03 to 11 percent.

⁴⁰ This analysis was provided to DRB by their former actuarial consultant, Mercer, in a memo dated February 14, 2005.

Administrative decisions of oversight boards have had limited impact on Plans' liabilities

In past years, if retirement-plan participants believed they had not received a benefit to which they were due under the terms of their plan, they could appeal to the respective oversight board for redress. The boards, after reviewing the complaint, could reverse a decision made by state agency administrators responsible for TRS and PERS.

In general, we determined that the boards were fiscally conservative in the nature of decisions they reversed – most typically overruling administrative agency decisions related to disability determinations. These rulings were limited to facts of the complaint for the individual involved and had little appreciable impact on subsequent decisions. Such circumscribed decisions limited the exposure of the respective Plan to pay out benefits in situations not originally contemplated when the programs were designed.

Unplanned financial liability to the Plans currently stems from two cases with recent or pending state Supreme Court rulings. The first is the recent court ruling that requires the State to provide benefits to same sex partners of eligible participants in the same manner as is now done for spouses of participants. The court made the ruling on the basis of the equal protection provisions of the state constitution. The ruling has the effect of establishing a new group of prospective beneficiaries to both Plans that were not originally contemplated when the retirement Plans were established. The oversight boards had made no decision in the disputes that served as a basis for this court decision.

The second case involves whether PERS should count the value of personal leave cashed-in when calculating the basis on which benefits are paid. The compensation of the highest three or highest five (depending on the “tier” classification of the retiree) years serves as the basis for calculating retirement benefits. The PERS board ruled that proceeds an individual receives, as payout for unused personal leave, should not be counted in determining annual compensation. The individual, involved, appealed the PERS board’s ruling to the Superior Court, which ruled in favor of the board. The individual is now appealing the case to the state Supreme Court.⁴¹

⁴¹ The case, titled *McMullen v. Bell* (State of Alaska), was originally decided by the PERS board in favor of the plaintiff, McMullen. The State appealed and the Superior Court remanded the decision to the PERS board for further fact finding. On remand, the PERS board reversed its earlier decision and ruled against McMullen’s position. McMullen then appealed to the Superior Court, which affirmed the second PERS board decision. McMullen has now appealed to the Alaska Supreme Court. The case has been fully briefed and argued, and is pending decision by the Supreme Court. The case was originally brought as a class action suit in Superior Court. The court declined to certify the class. Instead, the court granted the State’s motion to stay all proceedings pending the outcome of *McMullen v. Bell*. According to DOLaw, in all likelihood, the decision in *McMullen v. Bell* will determine the outcome of the class action.

Regulations with financial effect need to be updated

Certain regulations that financially affect the Plans have not been updated for a number of years. We recommend that the Division of Retirement and Benefits (DRB) review and, as necessary, update the regulations related to both Plans. (See Recommendation No. 1)

Asset allocations more conservative, but investment returns were consistent with other plans

A fundamental responsibility of ASPIB was to annually review the allocation of assets among various investment options in order to maximize return while minimizing risk. To assist with their financial decision making, the investment board worked with three advisors: (1) an external investment consultant – Callan Associates, Inc., (2) the Investment Advisory Council,⁴² and (3) Department of Revenue’s Treasury Division staff.

Exhibit 9

	Year	Average of 10 Comparable Funds	PERS	TRS
Asset Allocation to Equity	FY 02	58.6%	56.6%	56.5%
	FY 04	63.5%	58.3%	58.1%
Asset Allocation to Fixed Income	FY 02	30.7%	35.5%	35.7%
	FY 04	22.9%	30.7%	30.9%
Return on Assets	FY 02	-7.0%	-5.5%	-5.5%
	FY 04	16.0%	15.1%	15.1%

We reviewed ASPIB’s asset allocation decisions for FY 99 to FY 05. The board consistently adopted the asset allocation recommended by their advisors.

We also compared the equity and fixed income allocations and investment returns of the PERS and TRS to the average of ten other public pension plans of similar asset size. Comparisons were made of the asset allocations and returns during the most recent “bear” market (reflected in FY 02 returns) and during the recovery period (reflected in FY 04 returns).

As reflected in Exhibit 9, PERS and TRS equity allocations were more conservative than the average of the ten comparable plans in our analysis. The boards were also more conservative in investing in fixed income securities. PERS and TRS showed investment returns comparable to the other plans. Most notably, during the substantial FY 02 downturn, both PERS and TRS actually performed slightly better at retaining value compared to the other plans in our group. In FY 04, however, the ten comparable plans slightly outperformed PERS and TRS.

⁴² AS 37.10.270 sets up an advisory council made up of between three and five individuals that have “*experience and expertise in financial investments and management of investment portfolios for public, corporate, or union pension benefit funds, foundations, or endowments.*” This council reviews the investments made by ASPIB, makes recommendations concerning investment policy and procedures, advises the board on selection of performance consultants, and provides other advice as requested by the board.

Two-year lag in setting contribution rates has contributed slightly to unfunded liability

Both TRS and PERS have a two-year lag from the time the actuarial valuation is completed to the time the new rates, based on the valuation, are effective. For example, rates based on the valuation as of June 30, 2004 will not be effective until July 1, 2006. This lag can have a negative impact on each Plan's funding ratio because market conditions or costs may change so quickly, making the contribution rates too low to cover these increasing costs.

A lag exists for public pension plans because rates must be available to allow sufficient time to prepare the budget. In the state government's case, TRS and PERS boards' approved rates must be submitted to the state's Office of Management and Budget by the end of September, in any given year, to be integrated into the budget. This allows only three months to collect and review employer data, complete the valuation, and adopt contribution rates – a process that takes nine months.

According to the Plans' former actuary, a one-to-two year lag is common among public pension plans and 18 months is the most prevalent. In our review of ten state pension plans, we found that half of the plans had rates set by statute. Of the five that did not, three had a one-year lag, one had a two-year lag, and one that set rates for a two-year period had both a one-year and two-year lag.

Recent state appropriations offset higher contribution rates faced by participating employers

In recent years, the legislature has made appropriations to help employers pay for contribution rate increases. Most significantly, the legislature increased school foundation payments by 18 percent, in large part to compensate for higher TRS and PERS contribution rates faced by school districts.⁴³ This increase, estimated at over \$70 million for the two years (FY 05 and FY 06), when added to a \$18 million appropriation for local governments⁴⁴ and \$15 million in appropriations to the University of Alaska sums to more than \$100 million in state funding provided to help employers pay for the large increases in employer rates.

Essentially, by making such appropriations, the legislature was holding nonstate employers harmless, to some extent, for the higher rates. Although these participating employers are receiving offsetting funding now, it should be noted they also received significant cost savings in previous years when the PERS board cut employer rates substantially. The board cut the FY 98 rate by more than four percent and actuarial rates stayed relatively low for the

⁴³ The increase shows up in the higher base student allocation within the foundation formula, which drives state funding for public education. From FY 04 to FY 06, the base student allocation rose 18 percent from \$4,169 to \$4,919. Contained in this increase was more than \$70 million to offset higher contribution rates faced by local school districts for PERS and TRS personnel.

⁴⁴ Chapter 3, FSSLA 2005

next seven years through FY 04.⁴⁵ These lower rates resulted in cost savings of more than \$232 million for these nonstate government participating employers.

The appropriation methods used by the legislature varied depending on the type of participating employer.

- To assist school districts, the base student allocation for the school foundation formula was raised.
- To assist the University, additional funding was provided through two appropriations that were combined with other budget request items.
- To assist local governments, a direct appropriation to DOA, DRB, was made on their behalf.

Given the relatively volatile nature of the employer contribution rates, the legislature should consider using separate appropriations or allocations when contributing to the nonstate government participating employers. This would allow the legislature to better track supplemental amounts appropriated for the recently rising contribution rates. This type of tracking is beneficial because, in the long run, employer contribution rates will both rise and fall.

⁴⁵ For FY 98, the PERS board lowered the average employer rate from the FY 97 rate of 12.1 percent to 8 percent. The board lowered the rate again for FY 99 to 7.74 percent, for FY 01 to 7.4 percent, then to 6.75 percent for FY 02 through FY 04.

FINDINGS AND RECOMMENDATIONS

Recommendation No. 1

The director of the Division of Retirement and Benefits (DRB) should review and update the Public Employees' Retirement System's and the Teachers' Retirement System's (Plans) regulations.

Certain regulations that financially affect the Plans have not been updated for a number of years. According to DRB staff, the division has contracted with a former assistant attorney general to review the existing Plans' statutes and regulations and provide potential revisions to the commissioner of the Department of Administration early in 2006. We recommend that this review includes the following:

- The mortality table, used to factor the amount of reduction in an employee's monthly retirement to provide a surviving spouse or dependent with a continued monthly benefit, has not been updated to a newer table. Currently, the regulations for both Plans use the outdated 1984 UP84 Unisex Pension Mortality Table rather than the 1994 Group Annuity Mortality Basic Table adopted in 2002 to calculate the Plans' liabilities. The effect of not updating the regulation has increased liabilities by paying too high of retirement benefits to employees who have chosen an option to provide benefits to a spouse or dependent in the event of the retiree's death.
- Interest paid on employee contribution accounts under the Plans was last set at 4.5 percent in 1974. This amount of interest has been paid to the employee contribution accounts even when both Plans' rates of return on investments were negative.
- Repayment of indebtedness on an employee's contribution account includes interest paid by the employee. Both Plans have had the interest rate on indebtedness set at seven percent since 1974.

In order to limit the liabilities of the Plans and to maintain the actuarial soundness of each retirement Plan, regulations should be reviewed and, as necessary, updated at least annually.

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APPENDICES

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APPENDIX A

Legislation Affecting the PERS Plan For the Period 1986 through 2004

Chapter 82, SLA 1986 – Creates PERS Tier II and makes other changes

Tier II changes applied to new hires on or after July 1, 1986:

- Normal retirement age increased from 55 to 60 years of age and early retirement age increased from 50 to 55 years of age. This delayed the start of pension benefits by five years, thus decreasing pension costs.
- Retirees under 60 years old must pay full premium of medical coverage; 60 years old but under 65 years of age must pay one-half of the premium; and those retirees 65 years or older or disabled members received system-paid premium medical coverage. (Previously all retirees' medical premiums were system-paid.)

Changes made to retirement plan that *increased costs*:

- Automatic post pension retirement adjustments added to the plan. (Previously, only ad hoc post pension retirement adjustments were included.)
- Benefit calculation formula for service years earned after July 1, 1986 increased retiree benefits by raising percentage for second 10 years of service to 2.25 percent and 2.50 percent for all years earned thereafter. (Previously, all service years were calculated at 2 percent.)

Change made to retirement plan that *decreased costs*:

- Age requirement to receive Alaska cost-of-living adjustment restricted to retirees 65 years or older or disabled members regardless of age. (Previously, all retirees who remained domiciled in Alaska received the Alaska cost-of-living adjustment, regardless of age.)

Change made to retirement plan that *increased contributions*:

- Employees' contribution rates increased by 2.5 percent for police and fire and other employees, school district employee contribution rate increased by 5.35 percent.

APPENDIX A

Legislation Affecting the PERS Plan For the Period 1986 through 2004 (continued)

Chapter 4, FSSLA 1996 – Creates PERS Tier III

Tier III changes applied to: Retirement benefit recipients whose benefits were based on membership beginning after July 1, 1996:

- Retirees, except for disabled retirees, with less than 10 years of service, regardless of age, were required to pay the full premium for medical coverage. This decreased medical costs to the Plan by restricting system-paid medical premiums to those with 10 years or more of credited service.

Changes made to retirement plan that *decreased costs*:

- Benefit calculation formula's average salary basis changed from high consecutive three years to high consecutive five years for all retirees first hired on or after July 1, 1996.
- Actuarial adjustment for early retirement defined in statute as one-half of one percent per month every month retiree is less than normal retirement age.

Chapter 57, SLA 2001 – Expands system-paid medical coverage *increasing costs*

Change applied to new hires on or after July 1, 1986 but before July 1, 1996:

- Retirees 60 years of age or older or any age with 25 years (fire and peace officers) or 30 years of credited service received system-paid premium medical coverage. This provided system-paid medical coverage five years earlier.

Change applied to new hires on or after July 1, 1996:

- Retirees 60 years of age or older with at least 10 years of credited service or any age with 25 years (fire and peace officers) or 30 years of credited service received system-paid premium medical coverage. This provided system-paid medical coverage five years earlier.

Chapter 59, SLA 2002

Change in the average salary of peace officers and fire fighters *increases costs*:

- Benefit calculation formula's average salary basis changed from high consecutive five years for all retirees first hired on or after July 1, 1996 to high consecutive three years, regardless of hire date.

APPENDIX B

Legislation Affecting the TRS Plan For the Period 1986 through 2004

Chapter 97, SLA 1990 - Creates Tier II and makes other changes

Tier II changes applied to new hires on or after July 1, 1990:

- Normal retirement age increased from 55 to 60 years of age and early retirement age increased from 50 to 55 years of age. This delayed the start of pension benefits by five years, thus decreasing pension costs.
- Retirees under 60 years old must pay full premium of medical coverage; 60 years old but under 65 years of age must pay one-half of the premium; and those retirees 65 years or older or disabled members received system-paid premium medical coverage. (Previously all retirees' medical premiums were system-paid.)

Changes made to retirement plan that *increased costs*:

- Automatic post-pension retirement adjustments added to the plan. (Previously only ad hoc post-pension retirement adjustments were included.)
- Benefit calculation formula for service years earned after June 30, 1990 and that are more than 20 years of total credited service increased retiree benefits by increasing the percentage for those years of service greater than 20 years to 2.5 percent. (Previously all service years were calculated at 2 percent.)

Change made to retirement plan that *decreased costs*:

- Age requirement to receive Alaska cost-of-living adjustment restricted to retirees 65 years or older or disabled members domiciled in Alaska regardless of age. (Previously all retirees received the Alaska cost-of-living adjustment regardless of age.)

Change made to retirement plan that *increased contributions*:

- Employees' contribution rates increased by 1.65 percent beginning January 1, 1991.

Chapter 57, SLA 2001 – Expands system-paid medical coverage *increasing costs*

Retirees 60 years of age or older or any age with 25 years of credited service received system-paid premium medical coverage. This provided system-paid medical coverage five years earlier for retirees.

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Appendix C

Comparison of the State of Alaska Public Employees' Retirement System with Other Pension Plans

Plan Description	Funding Method
<p>State of Alaska Public Employees' Retirement System (PERS) is an agent, multiple-employer public employee retirement system established under Title 39.35 of the Alaska Statutes.</p> <ul style="list-style-type: none"> • Members are state and local government employees (including peace officer and fire employees and excluding teacher or other certified academic employees). As of June 30, 2004 there were 71,009 members. • PERS' consulting actuary is Mercer Human Resource Consulting, Inc. 	<ol style="list-style-type: none"> 1. Employee contribution rate is set by law at 7.5% for peace officer and fire employees and 6.75% for all other employees. (AS 39.35.160) 2. Employer contribution rate is actuarially determined for both normal and past service costs. 3. Assumed investment rate of return is 8.25% per annum for actuarial projections.
<p>The Arizona Public Safety Personnel Retirement System (PSPRS) is an agent multiple-employer public employee retirement system established by Title 39, chapter 5, article 4 of the Arizona Revised Statutes.</p> <ul style="list-style-type: none"> • Members are public safety employees of certain state and local governments. As of June 30, 2004 there were 23,584 members. • PSPRS' consulting actuary is Rodwan Consulting Company. 	<ol style="list-style-type: none"> 1. Employee contribution rate is set by law at 7.65% of compensation. (A.R.S. 38-843 C) 2. Employer contribution rate is actuarially determined for both normal and past service costs with a statutory floor set at 2%. (Floor increased to 5% with session law 2005, Chap. 208 effective July 1, 2006) 3. Assumed investment rate of return of 9.00% per annum is for actuarial projections. (Rate decreased July 1, 2004 to 8.75% with subsequent annual reductions of .25 % until the rate is reduced to 8.00%)
<p>Virginia Retirement System (VRS) is a mixed agent and cost-sharing, multiple-employer retirement plan.</p> <ul style="list-style-type: none"> • Members are state employees, teachers and public school board employees, employees of participating political subdivisions, and other qualifying employees. As of June 30, 2004 there were a total of 305,477 members. • VRS' consulting actuary is Gabriel, Roeder, Smith & Company. 	<ol style="list-style-type: none"> 1. Employee contribution rate is set by law at 5.0% of compensation. (COV 51.1 – 144) 2. Employer contribution rate is actuarially determined for both normal and past service costs. 3. Assumed investment rate of return is 8.00% per annum for actuarial projections.

Appendix C

Comparison of the State of Alaska Public Employees' Retirement System with Other Pension Plans

<p>Michigan State Employees Retirement System (MSERS) is a cost sharing, multiple-employer, statewide, defined benefit plan.</p> <ul style="list-style-type: none"> Members are state (civil) employees as well as appointed officials of the executive branch of state government and employees of both the legislative and judicial branches of state government. As of September 30, 2004 there were a total of 80,395 members. MSERS is a closed plan. All employees hired on or after March 31, 1997 are enrolled in a 401(k) defined contribution plan. During FY 98, the Michigan State Employees' Retirement Act provided members an opportunity to transfer to the defined contribution plan. This was a one-time opportunity and the decision was irrevocable. The transfer had to be completed by September 30, 1998. MSERS' consulting actuary is The Segal Company. 	<ol style="list-style-type: none"> Employees do not contribute to the defined benefit retirement plan except for purchase of past service credit. Employer contribution rate is actuarially determined in accordance with the actuarial reserve funding provisions of the Michigan Compiled Law 38.1 et seq. Assumed investment rate of return is 8.00% per annum for actuarial projections.
<p>Louisiana State Employees' Retirement System (LASERS) is a single employer defined benefit pension plan.</p> <ul style="list-style-type: none"> Members are state officers and employees. As of June 30, 2004 there were a total of 137,719 members. LASERS' consulting actuary is Hall Actuarial Associates. 	<ol style="list-style-type: none"> Louisiana Revised Statute (RS), Title 11.62 sets the employee contribution rates from 7.5% to 9.5% depending on the covered group of employees. Louisiana RS 11.102 provides that for each fiscal year, commencing with FY 90, for each of the public retirement systems, the legislature shall set the required employer contribution rate equal to the actuarially required employer contribution. Assumed investment rate return is 8.25% per annum for actuarial projections.

Appendix C

Comparison of the State of Alaska Public Employees' Retirement System with Other Pension Plans

State/ Plan Name	2001 and 2002 Investment Losses	Asset Valuation Method	As of June 30, 2004			Amortization Method of UAAL
			Market Value of Plan Net Assets	Actuarial Value of Plan Net Assets	Unfunded Actuarial Accrued Liability (UAAL)	
Alaska PERS ⁴⁶	\$659 million	5-year smoothing ⁴⁷	\$5.9 billion	\$5.8 billion	\$940 million	25-year fixed period as a level percentage of pay
Arizona PSPRS	\$1.6 billion	Rolling 7-year average	\$4.3 billion	\$4.8 billion	\$393 million (increased to \$1.1 billion as of June 30, 2005)	Rolling 20-year period as a percentage of pay
Virginia VRS	\$5.6 billion	5-year smoothing	\$37.8 billion	\$39.7 billion	\$4.3 billion	Closed 30-year as a level percentage of pay
Michigan MSERS	\$2.3 billion	5-year smoothing	\$9.4 billion	\$10.2 billion	\$1.9 billion	32-year period as a percentage of pay (decreased to a 31-year period for 2005 valuation)
Louisiana LASERS	\$748 million	4-year weighted average	\$6.6 billion	\$6.1 billion	\$4.1 billion	Set by law – remaining years of amortization 25 years (Legislation effective July 2004 increased remaining years between 24 and 30 years.)

⁴⁶ The amounts reported for PERS excludes health care assets and liabilities.

⁴⁷ All net investment losses accumulated as of June 30, 2002 were recognized, the actuarial value of assets was decreased and the unfunded liability increased, and the asset valuation methodology was changed to a 5-year smoothing methodology beginning with the June 30, 2003 valuation.

Appendix C

Comparison of the State of Alaska Public Employees' Retirement System with Other Pension Plans

Comparison of Funding Ratio

Fiscal Year	State of Alaska PERS System Funding Ratios ⁴⁸			Comparable State's Pension Only Funding Ratios			
	Total PERS Funding Ratio	PERS Health Care Ratio	PERS Pension	Arizona Pension	Virginia Pension	Michigan Pension	Louisiana Pension
2000	101.1%	96.8%	102.8%	124.7%	105.4%	109.1%	74.7%
2001	100.9%	96.0%	103.0%	126.9%	107.3%	107.6%	74.2%
2002	75.2%	56.1%	86.8%	113.0%	101.8%	98.7%	70.2%
2003	72.8%	50.9%	87.4%	93.6%	96.4%	84.5%	66.2%
2004	70.2%	47.7%	86.0%	92.4%	90.3%	84.5%	59.3%

Comparison of Employer Rates

Fiscal Year	State of Alaska PERS System Employer Rates ⁴⁹			Comparable State's Pension Only Employer Rates			
	Total PERS Employer Rate	PERS Health Care	PERS Pension	Arizona Pension	Virginia Pension	Michigan Pension	Louisiana Pension
2000	7.74%	2.11%	5.63%	5.21%	12.2%	5.4%	12.3%
2001	7.40%	2.12%	5.28%	5.21%	10.7%	5.2%	13.0%
2002	6.75%	1.94%	4.81%	4.21%	8.0%	4.1%	13.0%
2003	6.75%	2.00%	4.75%	3.75%	7.7%	4.3%	14.1%
2004	6.77%	2.01%	4.76%	7.66%	8.8%	5.5%	15.8%

⁴⁸ The allocation of the funding ratio between the actuarial value of pension assets and healthcare assets is the same proportion as the market values of those assets as presented in the actuarial valuations.

⁴⁹ The allocation of the employers' contribution rate between the pension costs and healthcare is the same proportion of actuarial accrued liabilities for each category as presented in the actuarial valuations which established the rate for the particular fiscal year.

Appendix D

Comparison of the State of Alaska Teachers' Retirement System with Other Pension Plans

Plan Description	Funding Method
<p>State of Alaska Teachers' Retirement System (TRS) is a cost-sharing, multiple-employer public employee retirement system established under AS 14.25.</p> <ul style="list-style-type: none"> • Members are certified teachers, university teaching staff, and other employees with academic standing in the State. As of June 30, 2004, there were 19,119 members. • TRS' consulting actuary for the June 30, 2004 actuarial valuation was Mercer Human Resource Consulting, Inc. 	<ol style="list-style-type: none"> 1. Employee contribution rate is set by law at 8.65% of base salaries. (AS 14.25.050) 2. Employer contribution rate is actuarially determined for both normal and past service costs. (AS 14.25.070) 3. Assumed investment rate of return is 8.25% per annum for actuarial projections.
<p>The Arkansas Teacher Retirement System (ATRS) is a cost-sharing, multiple-employer, combination contributory/non-contributory defined benefit pension plan established under Arkansas Code (ARC) Chapter 24.</p> <ul style="list-style-type: none"> • Members are teachers and other educationally related employees as defined by ACT 427 of 1973, as amended. As of June 30, 2004, there were 108,316 members. • ATRS' consulting actuary is Gabriel, Roeder, Smith & Company. 	<ol style="list-style-type: none"> 1. Employee contribution rate is set by law at 6% of gross earnings or \$7,800, whichever applies. Members' contributions before July 1, 1969 shall be in accordance with the provisions in force before July 1, 1969. (ARC 24-7-406(b)(2), (3) and (4)) 2. Employer contribution rate is actuarially determined for both normal and past service costs with statutory ceilings for FY 06 and FY 07 of 14% and 15%, respectively. (ARC 24-7-401) 3. Assumed investment rate of return is 8.00% per annum for actuarial projections.
<p>The North Dakota Teachers' Fund for Retirement (TFFR) is a cost-sharing, multiple-employer defined benefit pension plan established under North Dakota Century Code (NDCC) chapter 15.39.</p> <ul style="list-style-type: none"> • Members are all public teachers and certain other teachers who meet various membership requirements. As of June 30, 2004, there were 16,720 members. • TFFR's consulting actuary is Gabriel, Roeder, Smith & Company. 	<ol style="list-style-type: none"> 1. Employee contribution rate is set by law at 7.75% of gross earnings. (NDCC chapter 15-39.1-09) 2. Employer contribution rate is set by law at 7.75% of member's gross earnings. (NDCC chapter 15-39.1-09) 3. Assumed investment rate of return is 8.00% per annum for actuarial projections.

Appendix D

Comparison of the State of Alaska Teachers' Retirement System with Other Pension Plans

<p>Montana Teachers' Retirement System (MTRS) is a mandatory multiple-employer, cost-sharing defined benefit pension plan established under Montana Code Annotated (MCA) Title 19, chapter 20.</p> <ul style="list-style-type: none"> • Members are persons employed in Montana as teachers or professional staff of any public elementary or secondary school, community college or unit of the university system. As of June 30, 2004, there were 30,246 members. • MTRS' consulting actuary is Milliman Consultants and Actuaries. 	<ol style="list-style-type: none"> 1. Employee contribution rate is set by law at 7.15% of the member's annual compensation. Employers shall pick-up and pay member contributions. (MCA, Title 19, chapter 20-602) 2. Employer contribution rate is set by law at 7.47% of member's annual compensation. (MCA, Title 19, chapter 20-605) 3. Assumed investment rate of return is 7.75% per annum for actuarial projections.
<p>OKTRS is a mandatory/nonmandatory multiple-employer, cost-sharing defined benefit pension plan established under Oklahoma Statutes (OS) Title 70.</p> <ul style="list-style-type: none"> • Members are persons employed by state-supported education institutions. As of June 30, 2004, there were 134,728 members. • OKTRS' consulting actuary is Gabriel, Roeder, Smith & Company. 	<ol style="list-style-type: none"> 1. Employee contribution rate is set by law at 7.00% of the member's annual compensation. (OS Title 70) 2. Employer contribution rate is set by law (OS Title 70, sect.17-108-1) as follows: <ul style="list-style-type: none"> ▪ July 1, 1999 through June 30, 2000 4.8% ▪ July 1, 2000 through June 30, 2001 5.8% ▪ July 1, 2001 through June 30, 2002 6.8% ▪ July 1, 2002 through June 30, 2003 7.05% ▪ For each year after June 30, 2003 7.05% 3. The state contributes from its General Fund an amount equal to 3.25% of dedicated taxes beginning in 2000 and increases to 3.5% for each year thereafter. 4. Assumed investment rate of return is set by law at 7.5% per annum for actuarial projections

Appendix D
Comparison of the State of Alaska Teachers' Retirement System with Other Pension Plans

State/ Plan Name	2001 and 2002 Investment Losses	Asset Valuation Method	Market Value of Plan Net Assets	As of June 30, 2004		Amortization Method of UAAL
				Actuarial Value of Plan Net Assets	Unfunded Actuarial Accrued Liability (UAAL)	
Alaska TRS ⁵⁰	\$384 million	5-year smoothing ⁵¹	\$3.2 billion	\$3.1 billion	\$1.1 billion	25-year fixed period as a level percentage of pay
Arkansas ATRS	\$677 million	4-year smoothed market with 80%/120% corridor	\$8.1 billion	\$8.4 billion	\$1.6 billion	31-year level percentage of pay
North Dakota TFFR	\$217 million	5-year smoothing	\$1.4 billion	\$1.5 billion	\$354.8 million	20-year level percentage of pay ⁵²
Montana MTRS	\$279 million	5-year smoothing	\$2.4 billion	\$2.5 billion	\$873.5 million ⁵³	Infinite ⁵⁴
Oklahoma OKTRS	\$470 million	5-year smoothing	\$7.0 billion	\$6.7 billion	\$7.4 billion	Infinite ⁵⁵

⁵⁰ The amounts reported for TRS excludes health care assets and liabilities.

⁵¹ All net investment losses accumulated as of June 30, 2002 were recognized, the actuarial value of assets was decreased and the unfunded liability increased, and the asset valuation methodology was changed to a 5-year smoothing methodology beginning with the June 30, 2003 valuation.

⁵² Beginning with FY 05 the UAAL amortization period was increased by the board to a 30-year period.

⁵³ The UAAL as of June 30, 2005 increased to \$1.0 billion.

⁵⁴ An increase in the ECR of 2.87% would need to be implemented to maintain an amortization period of 30-years.

⁵⁵ Current employer rates set by statute do not provide sufficient contributions to amortize the UAAL within the statutory requirement of 30-years.

Appendix D

Comparison of the State of Alaska Teachers' Retirement System with Other Pension Plans

Comparison of Funding Ratio

Fiscal Year	State of Alaska TRS System Funding Ratio ⁵⁶			Comparable State's Pension Only Funding Ratio			
	Total TRS Funding Ratio	TRS Health Care Ratio	TRS Pension Ratio	Arkansas Pension	North Dakota Pension	Montana Pension	Oklahoma Pension
2000	99.6%	94.2%	115.9%	96.7%	101.6%	84.7%	53.7%
2001	95.0%	88.2%	96.7%	95.4%	96.4%	N/A ⁵⁷	51.4%
2002	68.2%	48.5%	75.4%	91.9%	91.6%	83.4%	51.4%
2003	64.3%	43.3%	72.5%	85.9%	85.1%	N/A	54.0%
2004	63.9%	38.5%	73.8%	83.8%	80.3%	74.0%	47.3%

Comparison of Employer Rates

Fiscal Year	State of Alaska TRS System Employer Rates ⁵⁸			Comparable State's Pension Only Employer Rates			
	Total TRS Employer Rate	TRS Health Care Rate	TRS Pension Rate	Arkansas Pension	North Dakota Pension	Montana Pension	Oklahoma ⁵⁹ Pension
2000	12.0%	2.1%	9.9%	12%	7.75%	7.58%	4.8%
2001	12.0%	2.2%	9.8%	12%	7.75%	7.58%	5.8%
2002	11.0%	2.0%	9.0%	12%	7.75%	7.58%	6.8%
2003	11.0%	2.2%	8.8%	12%	7.75%	7.58%	7.05%
2004	12.0%	2.5%	9.5%	13%	7.75%	7.58%	7.05%

⁵⁶ The allocation of the funding ratio between the actuarial value of pension assets and healthcare assets is the same proportion as the market values of those assets as presented in the actuarial valuations.

⁵⁷ Prior to FY 04, Montana's actuarial valuations were done biannually.

⁵⁸ The allocation of the employers' contribution rate between the pension costs and healthcare is the same proportion of actuarial accrued liabilities for each category as presented in the actuarial valuations which established the rate for the particular fiscal year.

⁵⁹ The Oklahoma Teachers' Retirement System is one of the five worst funded pension plans. The state legislature recognized this problem in 1998 and passed SB 1037 requiring the state to contribute 3.25% of dedicated taxes in 2000 and 3.5% for the years thereafter to the plan. Between FY 00 and FY 04 the state contributed approximately \$932 million in addition to the employees' and employers' contributions.

STATE OF ALASKA

DEPARTMENT OF ADMINISTRATION

OFFICE OF THE COMMISSIONER

FRANK H. MURKOWSKI, GOVERNOR

P.O. BOX 110200
JUNEAU, ALASKA 99811-0200
PHONE: (907) 465-2200
FAX: (907) 465-2135

April 26, 2006

Pat Davidson
Legislative Auditor
Division of Legislative Audit
P. O. Box 113300
Juneau, AK 99811-3300

Dear Ms. Davidson:

Re: Departments of Administration and Revenue Public Employee's Retirement System,
Teachers' Retirement System, and Alaska State Pension Investment Board

Thank you for the opportunity to provide the following response to the recommendation in the preliminary audit report referenced above.

Recommendation No. 1

The director of the Division of Retirement and Benefits should review and update the Plans' regulations.

On November 9, 2005, the Division began the aforementioned process. The Division hired a former attorney general to review all of the PERS and TRS regulations and to draft new regulations for the defined contribution plans for PERS and TRS in accordance with SB 141 enacted by the 24th Legislature.

It was recommended that regulations for PERS and TRS be reviewed annually. Three specific regulations were identified in the audit report and are listed below with a response from the Division noted thereafter.

1. The mortality table used to factor the amount of reduction in an employee's monthly retirement to provide a surviving spouse or dependent with a continued monthly benefit has not been updated to a newer table. Currently, the regulations for both Plans use the outdated 1984 UP84 Unisex Pension Mortality Table rather than the 1994 Group Annuity Mortality Basic Table adopted in 2002 to calculate the Plans' liabilities. The effect of not updating the regulation has increased liabilities by paying too high of retirement benefits to employees who have chosen an option to provide benefits to a spouse or dependent in the event of the retiree's death.

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APR 26 2006
LEGISLATIVE AUDIT

The Division concurs with the recommendation and will take action to revise this regulation. However, it is important to note that the changes can only be made to members' benefits prospectively in accordance with the Alaska Supreme Court case noted below.

The PERS and TRS are constrained by Article XII, sec. 7 of the Alaska Constitution from making changes to existing plan provisions that would diminish or impair member benefits. The article provides:

***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.*

The Alaska Supreme Court has held in *Hammond v. Hoffbeck*, 627 P.2d 1052 Alaska 1981, that rights under the state's retirement systems vest on employment and enrollment in the system. They reasoned that retirement benefits are an element of the bargained-for consideration given to an employee in exchange for the employee's assumption and performance of employment.

In *Sheffield v. APEA* 732 P.2d 1083 Alaska 1987 the Alaska Supreme Court determined an application of different actuarial factors that resulted in lower final benefit calculations was a diminishment of benefits as defined by *Hammond v. Hoffbeck*. As a result, members are entitled to the best set of factors that have been in effect during their membership in the retirement systems.

With the constitutional constraint, changes as proposed in the report recommendations that may act to reduce benefits can only be applied to members of the retirement systems who enter on or after the effective date of the change.

2. Interest paid on employee contribution accounts under the Plans was last set at 4.5 percent in 1974. This amount of interest has been paid to the employee contribution accounts even when both Plans' rate of return on investments was negative.

The interest setting function has been moved in SB 141 from the ASPIB Board (dissolved) to the newly created Alaska Retirement Management (ARM) Board effective October 1, 2005. The recommended interest paid on member contribution accounts governed under regulations 2 AAC 35.820 (PERS) and 2 AAC 36.150 (TRS), to reflect changes in the Plans rate of return on investment shall be forwarded to the ARM Board for consideration.

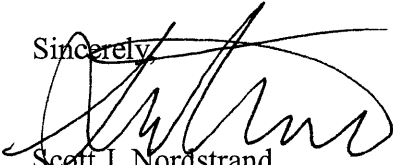
3. Repayment of indebtedness on an employee's contribution account includes interest paid by the employee. Both Plans have had the interest rate on indebtedness set at 7 percent since 1974.

The Division concurs with the recommendation and will take action to revise this regulation. However, it is important to note that the Alaska Supreme Court case noted above may affect

the Division's ability to change the interest rate on indebtedness balances established prior to the change.

Thank you again for the opportunity to respond to your recommendations.

Sincerely,



Scott J. Nordstrand
Commissioner

cc: Kevin Brooks
Deputy Commissioner

Eric Swanson, Director
Division of Administrative Services

Melanie Millhorn, Director
Division of Retirement and Benefits

Tom Boutin, Deputy Commissioner
Division of Treasury
Department of Revenue

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STATE OF ALASKA

DEPARTMENT OF REVENUE

OFFICE of the COMMISSIONER

FRANK MURKOWSKI, GOVERNOR

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April 25, 2006

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MAY - 1 2006

LEGISLATIVE AUDIT

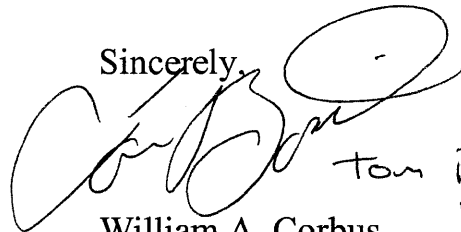
Danna Moser
In-Charge Auditor
Legislative Budget and Audit Committee
Division of Legislative Audit
P.O. Box 113300
Juneau, AK 99811-3300

Dear Ms. Moser:

RE: April 5, 2006 confidential preliminary audit report on Department of Administration and Revenue, Public Employees' Retirement System, Teachers' Retirement System, and Alaska State Pension Investment Board, Selected Issues, December 30, 2005

I can find no material differences of fact in your preliminary audit report. We have no facts or background which are substantively different from your discovery and conclusions. Everyone in state government will have better facts as new information, including updated actuarial information from new actuaries and reflecting SB 141, becomes available. Thank you for a very thorough look at this matter.

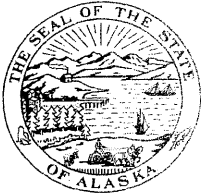
Sincerely,



William A. Corbus
Commissioner of Revenue

Tom Boutin for
Bill Corbus

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Alaska Retirement Management Board

P.O. Box 110405
Juneau, Alaska 999811-0405
(907) 465-3749

May 18, 2006

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MAY 18 2006
LEGISLATIVE AUDIT

Pat Davidson, Legislative Auditor
Legislative Budget & Audit Committee
Division of Legislative Audit
PO Box 113300
Juneau, AK 99811-3300

Dear Ms. Davidson:

As Chair of the Alaska Retirement Management Board (ARMB), I am responding to your letter of April 5, 2006 requesting a written and electronic response to the preliminary audit report on: *Departments of Administration and Revenue, Public Employees' Retirement System, Teachers' Retirement System, and Alaska State Pension Investment Board, Selected Issues, December 30, 2005*. The ARMB's response to the report is set forth below.

(1) Recommendation No. 1: *The director of the Division of Retirement and Benefits (DRB) should review and update the Public Employees' Retirement System's and the Teachers' Retirement System's (Plans) regulations.* The ARMB has been advised by DRB and its contract attorney that a complete review of regulations in light of the passage of SB141 is underway. This legislation also assigned regulatory authority to ARMB, and the board and its staff have worked in conjunction with DRB staff to ensure that all regulations are in place as required.

(2) Recommendation No. 1, second bullet point: *Interest paid on employee contribution accounts under the Plans was last set at 4.5 percent in 1974. This amount of interest has been paid to the employee contribution accounts even when both Plans' rates of return on investments were negative.* At its June 14-15, 2006 meeting, the ARMB will review and set the interest rate on employee contribution accounts. Under SB141, this interest rate is set by the board, not by regulation.

(3) Report Conclusions: Decreases in funding ratios were primarily due to investment losses and rising medical costs. The board respectfully disagrees with this statement. This phrase reflects unfairly on the prior board and staff by highlighting investment returns during a four-year period and ignoring investment performance that over the long run exceeded the actuarially required rate. Further, the information set forth on page 17 in support of the conclusion shows that in fact investment losses accounted for 33% of the decline for PERS and 28% for TRS. Medical costs, assumption changes, asset valuation changes and plan experience contributed 67% and 72% of the decline respectively. Neither the ARMB nor the prior board had any control over those contributing factors.

The ARMB appreciates the opportunity to comment on this preliminary audit report.

Sincerely,



Gail R. Schubert, Chair

ALASKA STATE LEGISLATURE

LEGISLATIVE BUDGET AND AUDIT COMMITTEE

Division of Legislative Audit



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May 19, 2006

Members of the Legislative Budget
and Audit Committee

We have reviewed the responses to our preliminary audit report. Nothing contained in these responses gives us cause to reconsider the report conclusions or findings. However, we want to clarify a part of the report referred to in the response from the Alaska Retirement Management Board (ARMB).

The board, in its response, took exception to our conclusion that "Decreases in funding ratios were primarily due to investment losses and rising medical costs." The board believes this statement reflects unfairly on the performance of the prior board members of the Alaska Pension Investment Board and the Department of Revenue staff. We disagree.

The objectives of this report regarding ASPIB were limited to determining the extent to which they followed their advisors' recommendations in adopting the Plans' asset allocation. Also, to compare the Plans' asset allocations and investment returns to other state public pension plans. Our conclusions regarding those objectives are reported on page 24.

Actual investment gains and losses result from multiple factors, including such items as general stock market fluctuations, changing interest rates, and investment strategies. However, we did no analysis and drew no conclusions regarding any individual causal factor of investment losses.

Sincerely,

A handwritten signature in black ink that reads "Pat Davidson".

Pat Davidson
Legislative Auditor

1
2 THE SUPERIOR COURT FOR THE STATE OF ALASKA
3 FIRST JUDICIAL DISTRICT AT JUNEAU

4 ALASKA RETIREMENT)
5 MANAGEMENT BOARD on behalf)
6 of STATE OF ALASKA PUBLIC)
7 EMPLOYEES' RETIREMENT SYSTEM)
8 and STATE OF ALASKA TEACHERS')
9 RETIREMENT SYSTEM,)

10 Plaintiff,)

11 v.)

12 MERCER (US), INC., MERCER HUMAN)
13 RESOURCE CONSULTING, INC., AND)
14 WILLIAM M. MERCER, INC.)

15 Defendants.)

16 Case No. 1JU-07- 979 CI

17
18 COMPLAINT

19 Plaintiff Alaska Retirement Management Board ("the ARM Board")
20 alleges for its Complaint, on information and belief as to allegations concerning other
21 parties:

22 Nature of the Action

23 1. This action seeks redress for actuarial malpractice, breach of
24 professional duty and breach of contract that have caused at least \$1.8 billion in
25 damages to the State of Alaska Public Employees' Retirement System ("PERS") and the
26 State of Alaska Teachers' Retirement System ("TRS"), two retirement and benefit plans
administered by the ARM Board.

ATTORNEY GENERAL, STATE OF ALASKA
DIMOND COURTHOUSE
P.O. BOX 110300, JUNEAU, ALASKA 99811
PHONE: 465-3600

027
Clerk of Superior Court
JEC 09 2007
JUNEAU, ALASKA

1
2 2. Beginning in the 1970s and until 2006, Defendants Mercer (US),
3 Inc. and its predecessors, defendants Mercer Human Resource Consulting, Inc., and
4 William M. Mercer, Inc. (collectively, "Mercer"), served as the actuarial firm for PERS
5 and TRS (collectively the "Plans"), Alaska's two largest public pension and benefit
6 plans. More than 80,000 Alaskans and former Alaskans who work for or who have
7 worked for over 200 participating public employers throughout the State look to or will
8 look to PERS and TRS for pension and post-retirement health benefits.
9

10 3. Holding itself out as "the global leader in retirement services,"
11 whose professionals use "state-of-the art tools," Mercer claims "offices in more
12 countries than any other HR consulting firm and over 4,800 retirement consultants and
13 actuaries worldwide." As the Plans' actuarial firm, Mercer had the responsibility to
14 perform critical functions for PERS and TRS, including the calculation of expected Plan
15 liabilities and the determination of employer contribution rates necessary to fund
16 benefits the Plans promised to workers and their families. Mercer understood that
17 accurate determinations of liabilities and contribution rates were essential to meet
18 fundamental objectives of the Plans.
19

20 4. Those objectives – which Mercer explicitly and repeatedly
21 acknowledged – included (a) *full funding* of the Plans – the accumulation of assets
22 sufficient (with expected earnings) to pay benefit obligations when they became due;
23 (b) the collection of contributions sufficient to fund each employee's future benefits
24 *during that employee's working lifetime*; (c) the maintenance of *relatively stable*
25 *contribution rates* over time, to prevent sudden changes that frustrate the orderly
26

1 financial plans of contributing employers responsible for essential governmental
2 functions; and (d) advance funding of *health care costs* as well as other benefit
3 obligations. The Administrator of PERS and TRS, acting on behalf of the trustees of
4 the Plans, retained Mercer to ensure that the Plans did not make empty, unfunded
5 promises, disrupt the financial planning of participating employers or burden future
6 generations with significant pension and health care costs.

7
8
9 5. Mercer's negligence and breaches of duty frustrated the Plans'
10 ability to achieve these funding objectives and injured the Plans. Fully aware of the
11 billions of dollars at stake, Mercer nevertheless made fundamental errors in
12 methodology and even in basic calculations, and failed to assign competent,
13 experienced personnel to work for the Plans. Because of this misconduct, Mercer
14 miscalculated – by over \$1.8 billion – the contributions necessary to fund the Plans.

15
16 6. The opportunity to collect those funds as planned has now
17 vanished. Participating employers have understandably committed the funds elsewhere
18 – for police officers, schoolbooks, parks, hospitals or other important functions – and
19 their financial planning has been disrupted by huge increases in contribution rates
20 caused by Mercer's misconduct. Just what the Plans wished to avoid – just what they
21 hired Mercer to prevent – has occurred.

22
23 7. Mercer's failure to meet its obligations to the Plans is one of the
24 most significant factors contributing to the financial crisis in Alaska's pension and
25 health system. Through this action, the ARM Board seeks to recover the more than
26

1
2 \$1.8 billion lost because of Mercer's conduct, and so help to restore the financial
3 stability of the Plans.

4 The Parties

5 8. Since October 1, 2005, the ARM Board has been the trustee of the
6 assets of PERS and TRS.

7
8 9. PERS is a retirement plan for employees of approximately 160
9 separate participating employers, including the State of Alaska as an employer, and
10 political subdivisions of the State, including municipalities, local government bodies,
11 housing authorities, and other public organizations throughout Alaska. It provides
12 defined pension, disability, survivor and health care benefits to plan members hired
13 prior to July 1, 2006, and their beneficiaries. Nearly 61,000 individuals and their
14 families now depend on PERS for benefits or will be eligible for benefits upon
15 retirement. PERS held approximately \$9.38 billion in assets as of June 30, 2006.
16

17 10. TRS is a retirement plan for educators in Alaska working at 58
18 separate public educational employers throughout the State. Like PERS, TRS provides
19 defined pension, disability, survivor and health care benefits to plan members who were
20 hired prior to July 1, 2006, and their beneficiaries. Nearly 20,000 individuals and their
21 families now depend on TRS for benefits or will be eligible for benefits upon
22 retirement. TRS held approximately \$4.3 billion in assets as of June 30, 2006.
23

24 11. Until the ARM Board was established on October 1, 2005, PERS
25 was overseen by the Public Employees' Retirement Board ("PERB") and TRS by the
26 Teachers Retirement Board ("TRB") (collectively, "the Boards"). From July 1, 1993,

1
2 until the establishment of the ARM Board, the Alaska State Pension Investment Board
3 ("ASPIB") acted as trustee of the assets of PERS and TRS and managed the investment
4 of those assets. Prior to July 1, 1993, the Commissioner of the Alaska Department of
5 Revenue acted as trustee of the assets of PERS and TRS and managed the investment of
6 those assets.

7
8 12. The Division of Retirement Benefits ("DRB") of the Alaska
9 Department of Administration administers PERS and TRS.

10 13. Mercer (US), Inc. (formerly known as Mercer Human Resources
11 Consulting, Inc., and as William M. Mercer, Inc.) is a Delaware corporation with its
12 principal place of business at 1209 Orange Street, Wilmington, Delaware, 19801.
13 Mercer presents itself as one of the most competent, sophisticated and experienced
14 advisors to pension and benefit plans. It claims that "Clients choose Mercer when they
15 want to work in partnership with their consultant, want strategic advice as well as
16 flawless administration and execution of their HR programs, want best-practice advice
17 and solutions tailored to their business and environment, or need global and/or local
18 perspectives and resources."

19
20 14. Mercer also represents that it has particular expertise in health care:
21 "Mercer combines health and benefits expertise from the world's leading benefits
22 consultancy with best-in-class technology and services to provide the resources and
23 support necessary to help employers design and deliver comprehensive health benefits
24 programs."
25
26

1
2 15. Mercer's fees reflect its promises of best-in-class performance:
3 Mercer received approximately \$2.5 million for its work for PERS and TRS between
4 June 1999 and April 2006, and billed the Plans at rates as high as \$430 an hour.

5 16. Mercer is a wholly owned subsidiary of Marsh & McLennan
6 Companies, Inc. ("Marsh"), which claims to be one of the world's largest consulting,
7 risk management and insurance brokerage firms. Marsh is a Delaware corporation with
8 its principal place of business at 1166 Avenue of the Americas, New York, NY 10036-
9 2774. Its shares trade on the New York Stock Exchange.
10

11 Jurisdiction and Venue

12 17. The Court has subject matter jurisdiction over this action pursuant
13 to AS 22.10.020. The amount in controversy exceeds \$100,000.00.

14 18. This Court has exclusive personal jurisdiction over Mercer
15 pursuant to the parties' contract, which provides that "[a]ll actions concerning this
16 contract shall be brought in the Superior Court of the State of Alaska." The Court also
17 has personal jurisdiction under AS 09.05.015(a). Mercer maintains an office at 1031
18 West 4th Avenue, Suite 400, Anchorage, Alaska 99501, and engages, and has engaged
19 in substantial business activities in the State of Alaska.
20

21 19. Venue is proper in the First Judicial District, among other reasons
22 because the Plans are administered by DRB in Juneau, the ARM Board, which serves as
23 the trustee of the Plans' assets, is based in Juneau, the series of contracts between DRB
24 and Mercer were negotiated and executed in Juneau, and Mercer regularly met and
25
26

1
2 communicated with representatives of the Plans in Juneau in connection with its work
3 for the Plans.

4 Operation of the Plans

5 20. PERS and TRS provide retirement, health, and other benefits to the
6 employees of their participating employers. Once promised, the amount of these
7 benefits is protected under the Alaska Constitution. To pay benefits, the Plans save for
8 the future, accumulating assets during the working careers of employees to pay benefits
9 in future years.
10

11 21. The Plans accumulate assets from three principal sources:
12 (a) contributions from participating employers; (b) contributions from employees
13 themselves; and (c) investment income earned on Plan assets. It is crucial that the Plans
14 receive sufficient contributions in order to have the resources to satisfy future benefit
15 obligations.
16

17 22. The Boards consistently adopted prudent, conservative funding
18 goals for the Plans. They rejected the practice of funding benefits on a pay-as-you-go
19 basis. Instead, they adopted these goals (among others):
20

21 23. *First*, the Boards wanted full, 100% funding – meaning that the
22 Boards expected to collect all of the contributions necessary (with expected earnings) to
23 pay expected benefits. In fact, in some years the PERS Board established a goal of
24 102% funding, to ensure that assets would be sufficient to pay for liabilities and for any
25 additional benefits granted retroactively to plan participants. A funding level of less
26 than 100% can force a plan to collect money as liabilities become due, rather than

1
2 saving in advance, and can saddle future generations with the obligation to pay prior
3 generations' benefits.

4 24. *Second*, the Boards wanted to fund each individual employee's
5 future benefits during that employee's working lifetime. Unlike other pension and
6 benefit plans, the Boards did not want one generation of employees to fund their
7 predecessors' or successors' benefit obligations. Every year, as employees enter and
8 leave the Plans and salaries fluctuate, the financial characteristics and composition of
9 the Plans changes. The Boards decided to collect in a given year the amounts needed to
10 pay for benefit obligations arising that year and a reasonable, actuarially calculated
11 portion of any prior accrued liability. This policy fairly allocates the cost of future
12 benefits, ensuring that those benefits will be funded in advance by the people who will
13 eventually receive them.
14

15 25. *Third*, the Boards wanted relatively stable employer contribution
16 rates. The participating employers in PERS and TRS are government entities, with
17 many demands on their limited funds. Establishing a funding goal of relatively stable
18 contribution rates affords the participating employers the ability to make sound
19 decisions about where to commit their remaining capital and how to fund essential
20 governmental functions.
21

22 26. *Fourth*, the Boards decided to require advance funding not only for
23 pension benefits, but for health benefits as well. This policy was not only prudent, but
24 also rare among public funds. According to statements made by Mercer, outside of
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1
2 Alaska, until recently public funds in only three other states accrued in advance for
3 health benefits.

4 27. Retirement and health plans depend on their actuaries to assist
5 them in achieving funding goals like those adopted by the PERS and TRS Boards. The
6 actuary's role is critical. Among other things, the actuary calculates the value of the
7 plan's current assets and the plan's future liabilities and determines the employer
8 contribution rates needed to achieve funding goals. In the case of PERS and TRS, the
9 actuary determines how much money, expressed as a percentage of payroll, each
10 employer should contribute each year to meet plan goals.

12 28. The Alaska Constitution prohibits the diminution of benefits, which
13 heightens the importance of accurate calculation of liabilities.

14 29. If the actuary improperly calculates the employer contribution rate,
15 the plan may not collect enough money to meet obligations as they come due. It is thus
16 imperative that the employer contribution rate be calculated correctly, and plans seek to
17 hire actuaries who promise that they can professionally, competently and correctly
18 calculate that rate.

19
20 **Mercer's Services to the Plans and the Boards**

21 30. Before and during the time it provided services to the Plans and the
22 Boards, Mercer held itself out as one of the most experienced, qualified and capable
23 employee pension and benefit consulting and actuarial firms in the world.

24 31. Beginning in the 1970s and continuing through March 22, 2005,
25 DRB and Mercer entered into a series of written contracts, which DRB and Mercer
26

1 understood were intended to benefit the Plans. Those contracts obligated Mercer to
2 provide a variety of actuarial consulting services to the Plans. These included:

3
4 (a) preparing actuarial valuation reports setting forth the actuarial
5 value of the Plans' assets and liabilities;

6 (b) calculating and recommending a consolidated employer
7 contribution rate and, also, employer contribution rates for each PERS employer, as
8 well as a system-wide employer contribution rate for TRS; and

9
10 (c) preserving, at least until May 2008, all notes and other work
11 product created by Mercer in the performance of its duties, providing access to those
12 materials on request.

13 32. Mercer prepared annual actuarial valuation reports for both PERS
14 and TRS.

15 33. The valuation reports informed the Plans, the Boards, participating
16 employees, Plan participants and beneficiaries, and the public of the funded status of the
17 plans. Thus, each valuation report set forth Mercer's calculations of the actuarial value
18 of the respective plan's assets and liabilities, as well as the resulting funding percentage
19 for the plan.

20 34. The valuation reports also included Mercer's "determination of the
21 appropriate contribution rate" for employers in the system. Based on its calculations
22 and professed expertise, Mercer determined an employer contribution rate that Mercer
23 represented would ensure that the Plans would achieve their funding goals.
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2 35. Mercer knew that a crucial function of its actuarial work was to
3 inform the Boards accurately of the Plans' funded status and provide the basis for
4 determination of employer contribution rates. Mercer knew that the Boards relied on
5 Mercer's work to make financial and administrative decisions regarding the Plans,
6 including whether to seek adjustments in contribution rates and whether to increase
7 benefits.
8

9 36. Recognizing the importance of its role, Mercer represented in each
10 valuation report its work was carried out by actuaries who were "fully qualified to
11 provide actuarial services to the State of Alaska," and that it had "employed generally
12 accepted actuarial methods and assumptions" in preparing each valuation.

13 37. Mercer regularly attended meetings of the Boards, where Mercer
14 actuaries presented the underlying assumptions, methods, findings and conclusions of
15 its valuation reports. Mercer actuaries advised the Boards as to the contribution rates
16 necessary to meet the Board's funding objectives, and as to the consequences of
17 decisions concerning benefits and other financial and operational matters.
18

19 38. Mercer fully understood and acknowledged the Plans' essential
20 funding goals. For example, at a January 23, 2003, joint meeting of the Boards, a
21 written presentation given by Mercer's Brian R. McGee repeated and confirmed all of
22 these goals:
23

- 24 • **Full funding:** Mercer confirmed that the Plans wanted a "100%,
25 or more recently for PERS, 102% target funded ratio of assets to
26 accrued liabilities";

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- **No inter-generational transfers:** Mercer confirmed that the Plans wanted to “pay for benefits during the working lifetime of employees”;
- **Stable rates:** Mercer confirmed that the plans wanted to have “relatively stable [contribution] rates over time”; and
- **Health care costs:** Mercer confirmed that the Plans wanted to accrue assets to pay for “retiree medical” costs, as well as other obligations.

39. Year in and year out, Mercer represented that its calculated employer contribution rates would allow the Boards to reach their funding goals. In reliance on Mercer’s analysis and recommendations, the Boards consistently adopted employer contribution rates designed to achieve the Plans’ conservative funding goals.

Mercer’s Errors

40. Despite Mercer’s representations that it was a fully qualified, global leader in retirement services, equipped with state of the art tools, and despite its certifications in each valuation report that it had used generally accepted actuarial methods, in fact – and unknown to the Boards at the time – Mercer’s work was riddled with significant errors. Mercer persistently neglected and disregarded its professional obligations and duties to the Boards and the Plans.

41. Beginning at least in the early 1990s, Mercer made critical errors in the annual valuation reports and other materials provided to the Boards and DRB.

Mercer erroneously calculated – and thus materially undervalued – the Plans’ liabilities,

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causing the Boards to adopt insufficient contribution rates and to make benefit increases that the Boards would not have made had Mercer discharged its professional obligations.

42. This complaint does not attempt to identify all of Mercer's errors. The most significant of Mercer's errors fall into two categories, health care errors and coding errors:

Health Care Errors

43. One of the most important of Mercer's responsibilities was to calculate the future health care liabilities, a major and growing obligation of the Plans. Mercer failed at this task, employing methods and assumptions that fell far short of professional standards. In fact, it appears that none of the actuaries who led Mercer's work for the Plans and signed valuation reports were health care actuaries, even though Mercer employed many health care actuaries among its thousands of consultants and actuaries around the world.

44. First, Mercer far underestimated the rate at which health care costs should be assumed to grow. In order to calculate future health care costs, it is essential to determine the "health cost trend," a calculation of the percentage change in health care costs in each year. For example, in the actuarial valuation report for PERS that Mercer issued for the Plan year ending June 30, 1999, Mercer used the following health cost trend:

FY99	9.5%
FY00	8.5%

FY01	7.5%
FY02	6.5%
FY03	5.5%
FY04-FY08	5.0%
FY09 & later	4.5%

The health cost trend numbers that Mercer used were much too low, significantly underestimating the amount by which health care costs should be assumed to increase. As Mercer knew, given the number of beneficiaries and the long time period involved, a change of just a few percentage points in the assumed health cost trend will have a huge effect on calculated liabilities. Accordingly, Mercer's error in choosing a health cost trend rate significantly understated the Plans' future benefit obligations and caused Mercer to calculate an employer contribution rate that was insufficient to meet true future obligations.

45. Second, Mercer compounded this error by failing adequately to monitor its health cost trend assumptions. Rather than determining the health cost trend annually, providing each year a new set of projections based on current real-world health conditions, Mercer calculated the health cost trend only every five years. For the next four years, Mercer applied its prior assumptions, without determining whether available information about health care costs required a change.

46. Because Mercer failed to monitor its assumptions each year, its valuation reports failed to reflect escalations in real-world health costs. For example, Mercer steadfastly maintained its projection that health care costs would grow by only

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2 7.5% in fiscal year 2001 even after actual health care costs increased by 20% in both
3 calendar year 1999 and 2000 and DRB projected costs to grow by 15% in calendar year
4 2001.

5 47. Third, Mercer failed to take into account real-world data in
6 determining the health care premium to use in calculating expected health care costs.
7 Mercer calculated health care costs for future years by multiplying an assumed health
8 care premium for the current year by the assumed percentage rate of increase.
9 Therefore, an error in the current year's premium would affect all future years. Each
10 year, DRB and the Plans informed Mercer of the actual health care premiums the Plans
11 were paying. Rather than using these real-world premiums each year, Mercer looked at
12 real-world data only every five years. In the intermediate four years, Mercer calculated
13 the health care premium by taking the prior year's premium and increasing it by
14 Mercer's health cost trend percentage for that year. Even as health care premiums
15 continued to increase in the real world, Mercer continued to ignore actual data and to
16 ignore the fact that its assumed costs were moving further off track each year. For this
17 reason as well, Mercer underestimated the Plans' true future health care liabilities and
18 recommended unreasonably low employer contribution rates.

19 48. In addition to these errors, Mercer failed to analyze the separate
20 components of health care costs or evaluate the health care needs of different groups
21 within the population of the Plans in the manner required of a competent actuary.
22 Medical costs typically vary based on age, and the costs of prescription drugs change at
23 a different rate than do other medical costs. Until 2005, Mercer ignored these issues,
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2 failing to consider differences between prescription drug costs and other health care
3 costs, and addressing population aging only by bluntly dividing Plan participants into
4 "over 65" and "under 65" categories. Mercer made these basic errors even though it
5 had been criticized as early as 1995 for not properly analyzing the age distribution of
6 the population. In a routine 1995 actuarial audit, the firm of Foster Higgins criticized
7 Mercer's method and recommended that Mercer modify its health care assumptions "to
8 reflect the age of your retiree group." Mercer ignored this advice until 2005.
9

10 49. According to figures reported by Mercer itself in the 2002
11 valuation reports for PERS and TRS, Mercer's erroneous calculations of the health care
12 cost trend and the health care premiums caused Mercer to understate the Plans'
13 liabilities by approximately \$1.3 billion.
14

15 Coding Errors

16 50. A second significant category of Mercer's errors are "coding
17 errors," errors in entering information about Plan benefits and provisions into Mercer's
18 computer models. As Mercer knew, an actuary's work depends on correct entry of data
19 into actuarial algorithms. Because the algorithms are applied to tens of thousands of
20 participants and beneficiaries, coding errors can cause massive mistakes, and competent
21 actuaries take care to prevent them. Mercer failed to do so.
22

23 51. Mercer's coding errors included:

24 (a) Incorrectly entering, and thus significantly overstating, the
25 reimbursement paid by Medicare for certain PERS members. This understated PERS's
26 liabilities;

1
2 (b) Assuming that certain retired employees of PERS and TRS
3 would make contributions toward their health benefits until age 65, when, in fact, those
4 employees contribute only until age 60. Mercer thereby overestimated the employees'
5 future contributions and underestimated the Plans' liabilities;

6 (c) Ignoring certain salary increases based on merit and seniority,
7 thus underestimating the salary-based benefits to which employees would be entitled;

8 (d) Assuming that certain retired employees of PERS members
9 would defer health care benefits until age 60, even though those employees are entitled
10 to full health care benefits at age 50, thereby underestimating PERS's liabilities;

11 (e) Ignoring survivor benefits for the spouses of certain employees
12 of PERS and TRS members, thereby underestimating the Plans' liabilities; and

13 (f) Omitting service beyond the normal retirement age when
14 projecting certain disability benefits, underestimating the Plans' liabilities.

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16
17 52. These basic errors show that Mercer failed to provide the care and
18 attention the Plans contracted for and deserved. In view of the size of PERS and TRS,
19 the coding errors had immense consequences. Taken together, they caused Mercer to
20 understate the Plans' liabilities by more than \$500 million.

The Milliman Audit

21
22 53. In 2002, the Boards and the Plans hired another prominent actuarial
23 firm, Milliman, Inc., to conduct a routine audit of Mercer's work. Milliman's limited
24 assignment was to "review the work of Mercer to see if it was reasonable, consistent
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and accurate." Milliman's audit report, issued in October 2002, revealed for the first time Mercer's major errors in calculating expected health care costs.

54. The Milliman audit report noted that "One of the most critical assumptions in the [actuarial] valuation is the expected increase in medical costs." Milliman concluded, however, that several of Mercer's actuarial assumptions used in calculating health care costs were not "reasonable and appropriate." Milliman criticized each of the three major health care errors committed by Mercer that are described above.

55. Milliman found that Mercer's health cost trend assumptions were far too low. Rather than the figures Mercer was then using - 7.5 percent in FY2001, trending down to 4 percent in FY2014 - Milliman's "healthcare actuaries would have recommended the assumption start within a range of 9% to 11% in 2001 with a gradual decline to about 5%."

56. Milliman also disapproved of Mercer's decision to revisit the health cost projections only every five years, advancing one year through the assumed progression in each of the four intervening years. Milliman determined that Mercer should revisit the assumption annually, and that simply moving one year down the schedule without a searching review was an error: "We recommend that this assumption be reviewed prior to every valuation until such time as medical costs have stabilized close to the rate of price inflation. In our opinion, the 2001 valuations should not have simply moved one year down the schedule without a thorough review."

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57. Milliman also criticized Mercer's failure to use available current data on health care premiums. Milliman warned that "Given the recent history of medical cost increases, the Mercer method can significantly understate liabilities if the actual increases are greater than the assumed increases." Milliman found that Mercer's approach was unreasonable, producing inaccurate results:

 Mercer anchored the blended premium several years ago and has escalated it by the assumed increases. Therefore, the blended premium used in the 2001 valuations was \$577.40 when the actual blended premium was \$668.00. This means the valuations are using a starting point for the projection of future medical costs that is almost 14% lower than the current blended premium. It would take three years for the assumed premium to catch up with the actual premium if there is no medical inflation during that time. This does not appear reasonable to us.

Milliman recommended that "the valuations always adjust the starting point for future projections based on the latest actual premium levels."

58. Milliman's report also revealed for the first time several of Mercer's coding errors, including Mercer's incorrect use of salary data and incorrect projection of disability benefits.

59. After communicating its findings to Mercer, Milliman presented the results of its audit to a joint meeting of the Boards on October 24, 2002. Mercer's actuaries attended that meeting. Tellingly, Mercer made no effort to mount any significant defense of its work. It accepted without debate all of Milliman's criticisms of its health care calculations and coding errors.

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2 60. The Mercer representatives at the meeting did not reveal that
3 Mercer's own health care actuaries agreed with Milliman's criticisms. In October 2002,
4 in response to the Milliman audit, Mercer's "State of Alaska Team" actuaries sought the
5 advice of a Mercer actuary who was a health care expert. Like the Milliman actuaries,
6 this Mercer health care actuary concluded in an internal memo that the health cost trend
7 assumptions Mercer was using were "low." The memo observed that it "seems
8 unrealistic to expect a sudden decrease in" the trend rate "in the next two to three
9 years." This health care actuary concluded that the trend assumption that the State of
10 Alaska Team was using "falls below the lower end of the trend range recommended by
11 the AFSC [Mercer's own Actuarial Finance Steering Committee] and is also below the
12 20th percentile of valuation trend assumptions for Mercer valuations from 2001."
13
14 Worse, the effect of the "low trend assumption may also be compounded by a cost per
15 retiree assumption that is currently 13.6% below the actual premium."
16

17 61. Mercer kept this analysis secret from the Boards and DRB. The
18 internal memo describing the analysis was disclosed only years later, when the Plans
19 demanded that Mercer disclose its work papers in connection with the investigation of
20 this case.
21

22 Damage to the Plans

23 62. Taken together, Mercer's health care errors and coding errors,
24 manifestations of Mercer's persistent disregard for its contractual and professional
25 responsibilities to PERS and TRS, caused Mercer to undervalue PERS' and TRS'
26 liabilities by at least \$1.8 billion.

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63. The opportunity to raise those funds from the participating employers as the obligations were incurred is gone, as is the participating employers' opportunity to raise the needed funds from taxpayers and other sources of revenue. Mercer's errors have frustrated the Plans' abilities to meet the very funding goals that they explained to Mercer, that Mercer understood, and that Mercer was hired to help the Plans meet.

64. As Mercer anticipated, the employers participating in PERS and TRS make spending decisions each year based, in part, on the contribution rates adopted by the Boards on the basis of Mercer's actuarial valuations. The funds that the Boards would have otherwise raised were never collected from taxpayers or have been spent by employers on governmental obligations and services. Employers cannot simply save now to fund benefits for which they should have saved years ago. Nor can they reverse the expenditures they made years ago in reliance on Mercer's actuarial calculations.

65. Absent a recovery of damages, those employers find themselves in exactly the position that the Boards worked to prevent: the employers must fund benefits for current workers and, at the same time, pay off unexpectedly high past liabilities.

66. The Plans' goal to fund an employee's future benefits during that employee's working lifetime also cannot be achieved. Instead, participating employers, while straining their finances to fund the benefits of current employees, must now make contributions to fund benefits for past employees long after their working lifetimes.

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2 67. Mercer was retained to help prevent just these problems. Instead,
3 its misconduct, negligence and inattention has injured the Plans. It is the actuary's task
4 – it was Mercer's duty – to calculate properly and reasonably the amount that the
5 Boards needed to collect in order to meet their funding goals. Had the Boards known
6 the Plans' true liabilities, they would have taken measures necessary to ensure that
7 PERS and TRS were fully funded. Instead, in breach of its duties, Mercer
8 underestimated the Plans' liabilities and damaged the Plans by the amount of the
9 underestimated liabilities.
10

11 68. Mercer's errors also caused the Plans to commit to obligations they
12 would not otherwise have incurred. Relying on Mercer's underestimation of the Plans'
13 liabilities, the Boards voted to award more than \$140 million in Ad Hoc Post-
14 Retirement Pension Adjustments, and the Commissioner of Administration concurred.
15 Those benefits would not have been awarded had Mercer provided accurate valuations.
16 Now awarded to Plan participants, those benefits cannot be rescinded.
17

18 FIRST CAUSE OF ACTION

19 (Professional Negligence and Malpractice)

20 69. The ARM Board repeats and realleges the allegations of paragraphs
21 1 through 68.

22 70. Mercer owed the ARM Board and the Plans a duty to use such
23 skill, prudence, and diligence as other members of the actuarial profession commonly
24 possess and exercise.
25
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2 71. By its persistent errors and failure to act in accordance with its
3 professional responsibilities, Mercer breached that duty.

4 72. The ARM Board and the Plans reasonably and properly relied upon
5 Mercer's advice.

6 73. As a direct, proximate, and foreseeable result of Mercer's breach of
7 its duty, the Plans sustained damages in an amount to be determined at trial, but no less
8 than \$1.8 billion.

9
10 **SECOND CAUSE OF ACTION**

11 **(Breach of Contract)**

12 74. The ARM Board repeats and realleges the allegations of paragraphs
13 1 through 73.

14 75. Mercer entered into a series of written agreements with DRB to
15 serve as the Plans' actuary. Among other things, these agreements obligated Mercer to
16 provide accurate and reliable actuarial services on behalf of PERS and TRS and to
17 exercise due care in performing services for the Plans.

18 76. The Plans and the Boards are intended and/or third-party
19 beneficiaries of those agreements.

20 77. The ARM Board, the Boards, DRB, and the Plans performed all of
21 their obligations under the contracts with Mercer.

22 78. By repeatedly committing errors in providing actuarial services to
23 the Plans, the Boards, DRB, and the ARM Board, and in failing promptly to discover
24 and disclose those errors, Mercer breached its contractual obligations.
25
26

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2 79. As a direct and foreseeable consequence of Mercer's repeated
3 breaches of its obligations under the agreements, the Plans have suffered damages in an
4 amount to be determined at trial, but in no event less than \$1.8 billion.

5 **THIRD CAUSE OF ACTION**

6 **(Breach of Implied Covenant of Good Faith and Fair Dealing)**

7 80. The ARM Board repeats and realleges the allegations of paragraphs
8
9 1 through 79.

10 81. Under its agreements with DRB, Mercer owed the duty of good
11 faith and fair dealing implied in all contracts governed by Alaska law.

12 82. The ARM Board, the Boards, DRB, and the Plans performed all of
13 their obligations under the contracts with Mercer.

14 83. By repeatedly committing errors in providing actuarial services to
15 the Plans, the Boards, DRB, and the ARM Board, and in failing promptly to discover
16 and disclose those errors, Mercer violated its implied duty of good faith and fair dealing.

17
18 84. As a direct and foreseeable consequence of Mercer's breach of its
19 duty of good faith and fair dealing, the Plans have suffered damages in an amount to be
20 determined at trial, but in no event less than \$1.8 billion.

21 **FOURTH CAUSE OF ACTION**

22 **(Negligent Misrepresentation)**

23 85. The ARM Board repeats and realleges the allegations of paragraphs
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25 1 through 84.

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86. Mercer made false representations, including regarding its use of reasonable actuarial methods and assumptions in rendering actuarial advice to the Plans, the Boards, DRB, and the ARM Board, regarding its calculation of liabilities of the Plans and Plan contribution rates, and regarding the qualifications and abilities of the individuals who performed work for the Plans.

87. These representations were materially false and Mercer, in the exercise of reasonable care, would and should have known of their falsity.

88. Mercer was required to take reasonable care to insure that its representations were accurate.

89. The Plans and the Boards reasonably and justifiably relied on Mercer's representations.

90. As a direct, proximate, and foreseeable result of Mercer's negligent misrepresentations, the Plans have suffered damages in an amount to be determined at trial, but in no event less than \$1.8 billion.

FIFTH CAUSE OF ACTION

**(Unfair Trade Practices under Alaska's
Unfair Trade Practices and Consumer Protection Act, AS 45.50.471)**

91. The ARM Board repeats and realleges the allegations of paragraphs 1 through 90.

92. Mercer entered into a series of commercial agreements with DRB to serve as the Plans' actuary.

1
2 93. In connection with these agreements, Mercer made false and
3 misleading representations, including regarding (a) the methods and assumptions used
4 to render actuarial advice to the Plans, the Boards, DRB, and the ARM Board;
5 (b) calculation of the Plans' liabilities; (c) calculation of Plan contribution rates; and
6 (d) the qualifications and abilities of the individuals who performed work for the Plans.

7
8 94. These false and misleading representations in fact misled and
9 deceived the Plans, the Boards, DRB, and the ARM Board in connection with the
10 services provided by Mercer violation of Alaska's Unfair Trade Practices and Consumer
11 Protection Act, AS 45.50.471.

12 95. As a direct, proximate, and foreseeable result of Mercer's conduct
13 described herein, the Plans have suffered damages in an amount to be determined at
14 trial, but in no event less than \$1.8 billion, subject to trebling under the Unfair Trade
15 Practices and Consumer Protection Act.

16
17 WHEREFORE, the ARM Board requests judgment awarding:

- 18 1. Damages in an amount to be determined at trial, but in no event
19 less than \$1.8 billion;
- 20 2. Treble damages under AS 45.50.531;
- 21 3. Pre- and post-judgment interest at the legal rate;
- 22 4. The costs and expenses of this action, including attorneys' fees
23 under AS 45.50.537 and as otherwise provided by law; and
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5. Such other and further relief as the Court deems just and proper.

DATED this 6th day of December, 2007 at Juneau, Alaska.

TALIS J. COLBERG
ATTORNEY GENERAL

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Alaska Department of Administration

Retirement and Benefits



PERS

TRS

State of Alaska

Public Employees' Retirement System Teachers' Retirement System

Presentation to the House Finance Committee on PERS/TRS 2009



History of PERS & TRS

- TRS established in 1955
- PERS established in 1961



Who is Covered in the System?

Public Employers/Employees & Teachers

- Cities, boroughs, some hospitals, school districts, State of Alaska
- Optional for political subdivisions



ARM Board & Consolidation of Governance

- Several separate boards before –
ASPIB, PERB and TRB
- 2004 SB 141 consolidation in Alaska
Retirement Management Board



PERS

TRS

PERS SYSTEM

Defined Benefit (DB)

Retirement Income

Health

**Disability
(Occupational and
Non-occupational)**

Survivor

Defined Contribution Retirement (DCR-Hybrid)

Retirement Income

Health + HRA

**Disability
(Occupational)**

Survivor



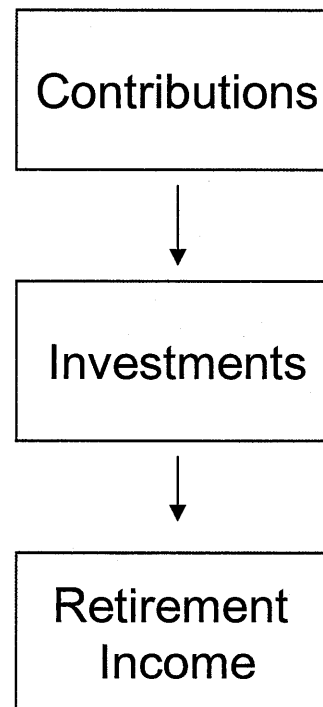
Constitutional Prohibition Against Diminishment

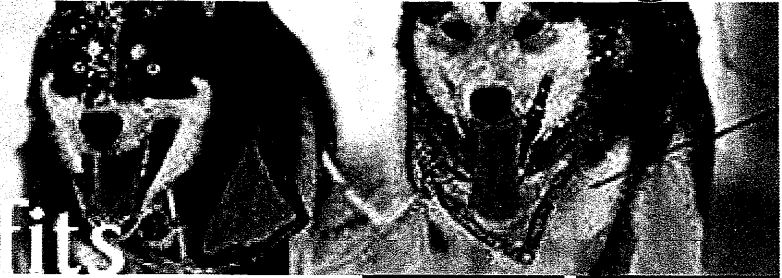
Article 12, section 7 - Retirement Systems.

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.



How Does the Retirement System Work?





Contributions

- Employee & Employer
- SB 125, General Fund – to pay down unfunded liability



PERS

TRS

Contributions Employee

Defined Benefit (DB)

**6.75% PERS and 7.5%
PERS Peace Officer and
Firefighter**

8.65% TRS

Statutory

Defined Contribution Retirement (DCR-Hybrid)

8% PERS

8% TRS

Statutory



Contributions

Employer - Rates

- ARMB Adopted Rates: 35.22% PERS, 44.17% TRS
- Statutory: 22.00% PERS, 12.56% TRS
- SB 125: Difference paid by state. (FY09 Budgeted & FY10 Governor's Request PERS \$241,600,000, TRS \$206,300,000)



ARMB Adopted Rate

- Valuations/Rate adopted by ARMB (based on over 25 variables set by ARM Board)
- Examples: Investments – rate of return and assets value, life expectancy, payroll growth, future healthcare costs



ARMB Adopted Rate

- Normal Cost pays for this year's benefit accrual only
- Past Service Cost pays for unfunded liability



PERS

TRS

ARMB Adopted Rate

	PERS	TRS
Normal Cost	→ 13.72%	9.37%
Past Service	→ <u>21.50%</u>	<u>34.80%</u>
ARMB Adopted	→ 35.22%	44.17%
Statutory Rate	→ 22.00%	12.56%



Investments

- Assumptions and Asset Allocations
(current rate of return assumption
8.25%; stocks, bonds, real estate)
- Long-term view – 5 yr. smoothing
- CY2008 PERS losses = DB (22.24%)
DCR (35.46%)

Investments

- Needed for cash flow – contributions alone are not sufficient to make benefit payments as more people retire



Pay – Retirement Income

- Over 32,500 retirees
- 60% in state, 40% out of state
- \$60 million per month retiree income
- \$25 million per month in additional retiree & dependent health care

Unfunded Liability

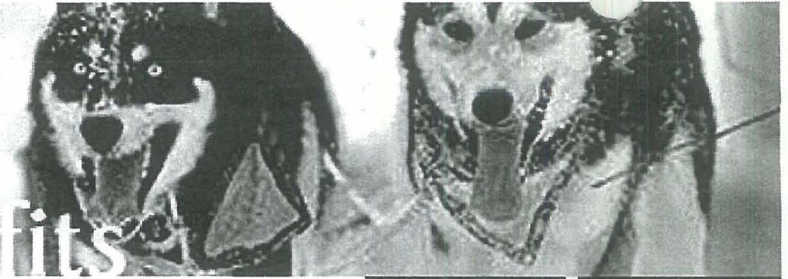
- Funding ratio = assets ÷ liabilities
- 2001/2002 – investment losses from technology crash



*then when
oil was lowest
& had over
been*

Unfunded Liability

- Both PERS and TRS enjoyed funding ratios over 100% through 2003
- Funding levels reflect combined pension and OPEB liabilities
- With the market downturn in the early 2000s, recognition of OPEB costs and other actuarial adjustments, ratios have fallen to the 60% range
- Contribution requirements that were steady or declining rose markedly in 2005 and after
- Alaska is not alone



Alaska's Response

- DCR-Hybrid SB 141 – new retirement plan + new employer-funded health benefit plan
- SB 123 clean-up bill – assess all payroll at statutory rate *22% PERS
12.56% TRS*
- SB 125 State pays difference between PERS 22%, TRS 12.56% statutory & ARMB adopted rate

The Future of Public Employee Retirement Systems was debated at the May 2008 Pension Research Council Symposium co-sponsored with the Wharton School's Boettner Center. Executive Director **Olivia S. Mitchell** co-hosted the event with **Gary Anderson**, and the Keynote Speaker was **Girard Miller** from the Governmental Accounting Standards Board.



Girard Miller, Olivia S. Mitchell, and Gary Anderson discuss public pension options.

The Council's newest research project compares public pensions and retiree health plans with their private sector counterparts. Under scrutiny are public sector accounting and management practices, as they differ from ERISA conventions, especially regarding liability measurement. Also of interest are funding patterns of public retirement systems (including civilian and military) and international reforms in Germany, Japan, and Canada.



Carla Brewer and Sarah Holden review pension plan structure.

As states, cities, and the federal government encounter budget stringencies, public plans are attracting attention and even envy when taxpayers see relatively generous benefits for public officials compared to what they may have for themselves. Yet Anderson advises that the focus must remain on those 'on the line' including firefighters at an emergency, utility workers fixing broken water lines, teachers entrusted with the next generation, and many more.

PRC Upcoming Events

- April 30-May 1, 2009: Symposium /Board Meeting
- October 22-23, 2009: Senior Partner Dinner and Board Meeting
- April 29-30, 2010: Symposium/Board Meeting

Upcoming Conference: The Spring 2009 PRC Symposium on "Reorienting Retirement Risk Management" takes place in Philadelphia at Wharton.



David Blitzstein and Phyllis Borzi evaluate policy in the public pension arena.

Speakers will evaluate new retirement roles for employers and plan sponsors, assess retirement adequacy, and explore changing roles for capital markets, institutions, and governments.



David Vanderweide



Beth Hirschhorn

PRC News

Raimond Maurer completed a study on retail investment products such as unit-linked life insurance, investment funds, certain structured notes and certificates for the European Investment Management industry. **Olivia S. Mitchell** has taken on the Chairmanship of the Wharton Department of Insurance & Risk Management. **Anna Rappaport** testified for the ERISA Advisory Council on phased retirement and pension distribution.



Pension experts Jon Sabelhaus, Robert Clark, Yumiko Watanabe, and Junichi Sakamoto

The Pension Research Council of The Wharton School of the University of Pennsylvania generates research and debate on pensions and other employee benefits. www.pensionresearchcouncil.org

PRC Publications

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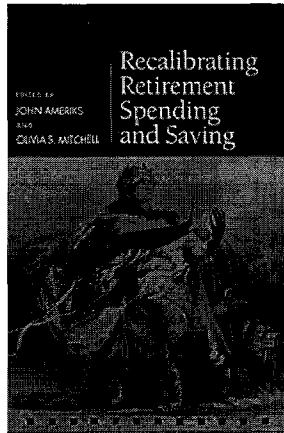
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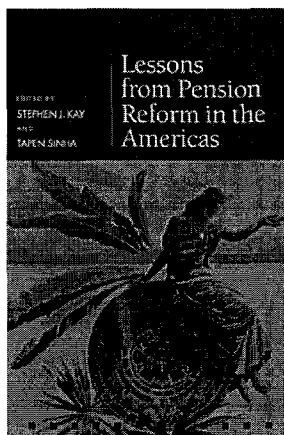
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Recalibrating Retirement Spending and Saving. Eds. *John Ameriks and Olivia S. Mitchell.* As Baby Boomers transition into their 60s, policymaker and media attention is focusing on how this generation will manage their money over retirement. The book explores how people entering retirement can deploy their accumulated assets to meet their myriad spending, investment, and other objectives. ISBN 0-19-954910-86.



Lessons from Pension Reform in the Americas. Eds. *Stephen J. Kay and Tapen Sinha.* The Americas have seen numerous experiments with pension reform, some of which are now being re-evaluated. This book reassesses these pension reforms in the light of demographic trends and capital market developments; examples include the United States, Canada, Mexico, Costa Rica, Brazil, Peru, Uruguay, and Argentina. ISBN 0-19-922680-6.



To order books online

[www.pensionresearchcouncil.org/
publications/books.php](http://www.pensionresearchcouncil.org/publications/books.php)

Redefining Retirement: How Will Boomers Fare? Eds. *Brigitte Madrian, Olivia S. Mitchell, and Beth J. Soldo.* This book offers an invaluable study of Boomers as they enter retirement. On average they are projected to be better off than their predecessors, having benefited from the long run-up in housing prices, better healthcare, and economic growth, many in this large generation will require new approaches to retirement risk management. Analysts offer new evidence about prospects for health, income, retirement pensions, portfolio allocation, and financial literacy. ISBN 0-19-923077-3.

Restructuring Retirement Risks. Eds. *David Blitzstein, Olivia S. Mitchell, and Stephen P. Utkus.* Retirement security is one of the central policy concerns of our time, yet pension systems confront deep challenges and governments are unsure how to proceed. Although retirement systems are stressed by volatile capital markets, poor corporate earning streams, weak macro-economic performance, and international turmoil, contributors offer creative guidance to pension fiduciaries, plan participants, and policymakers. ISBN 0-19-920465-9.

Pension Design & Structure: New Lessons From Behavioral Finance. Eds. *Olivia S. Mitchell and Stephen P. Utkus.* This book draws on behavioral finance to challenge key assumptions behind commonly held theories of retirement decision-making. Authors trace implications of frontier research in psychology, marketing, and economics, to enhance pension system design and structure. ISBN 0-19-927339-1.

Forthcoming

The Future of Public Employee Retirement Systems, Eds. *Olivia S. Mitchell and Gary Anderson.*

For more information

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Nebraska Pension Debate Fact Sheet

About the Plan

The State Employees' Retirement plan began as a defined contribution plan in 1964. The cash balance benefit was added by passage of LB687 on April 18, 2002. As of January 1, 2003, members who begin participation in the State Employees' Retirement Plan (the Plan) participate in the cash balance benefit. Active plan participants at that time were given the option of *keeping* their defined contribution benefit or *converting* to the cash balance benefit.

Why the Switch?

In 1999, the executive director of Nebraska PERS, Anna Sullivan and AFSCME leadership had many examples of employees making poor decisions with their defined contribution pension plans.

- A majority left their funds in the default fund which was very conservative.
- Many who had invested in equities played the market, traded often and continually lost.
- Many who retired or quit took a lump sum payment.
- Ms. Sullivan declared that tax payer money was being wasted by contributing to the DC plan compared to a DB plan.

Study Findings:

- Buck Consultants was hired to do a study on pension adequacy in 2000.
- Findings: between the years 1983 and 1999, the DB plans yielded an average return of 11% compared to 6% for the DC plans.
- DB plans replaced income averaging between 60-70% and the DC plan provided between 25-30% income replacement.
- Half of all the money in workers' accounts ended up in the conservative default investment. Although the state offered 11 fund choices, 90% of the money went into three funds.

Solution:

- Legislation was proposed to move all employees into a cash balance plan and to allow current employees to switch to the cash balance plan.
- Passed with little opposition in 2002 (Republican majority and Governor)
- Factual basis for change was done by Buck Consulting.
- Argument that DC plan wasted tax dollars played well.
- No additional contributions or additional taxes needed.

Benefit:

- Contribute 4.8% pre-tax to the plan. The State contributes 156% of employees' contributions (7.5% of salary). Total contribution 12.3%
- May retire as early as age 55.
- Are vested after three years.
- Member accounts receive an "interest credit rate" (rate of return) based on the federal mid-term rate plus 1.5% and are *guaranteed* a minimum annual rate of return of 5%.
- May rollover employee and employer contributions at retirement.
- Pay record keeping fees.

Keys to the Change:

- Strong leadership from Anna Sullivan, Executive Director of PERS who was well liked by the legislature.
- The data from Buck Consulting was in favor of DB plan – facts on their side.
- Legislative Retirement Committee had members who were knowledgeable about retirement issues.
- Support of the other unions.

February 12, 2009

VIA EMAIL

Mr. Pat Shier
 Director
 Division of Retirement and Benefits
 Department of Administration
 State of Alaska
 333 Willoughby Avenue
 6th Floor State Office Building
 Juneau, AK 99811-0208

**Re: Alaska PERS and TRS
 Comparison of DB versus DCR Ongoing Costs**

Dear Pat:

As requested, we are providing a comparison of the costs between the Defined Benefit (DB) plans and the Defined Contribution Retirement Plan (DCR) for the State of Alaska Teachers' Retirement System (TRS) and Public Employees' Retirement System (PERS). The results provided represent employer costs as a percent of pay for FY11 and are net of member contributions. The comparison is between the most recent tier of the DB plan (Tier 2 for TRS, Tier 3 for PERS) and the DCR Plan (Tier 3 for TRS, Tier 4 for PERS). The rates were determined using the payroll applicable to each group and are not based on total payroll.

RESULTS

The following results compare the DB and DCR ongoing plan costs:

Public Employees' Retirement System (All Members)	DB Plan Tier 3	DCR Plan Tier 4*
DB Plan Employer Normal Cost Rate	2.97%	N/A
DC Employer Contribution Rate	N/A	5.00%
Occupational Death and Disability Normal Cost Rate	N/A	0.38%
Medical Normal Cost Rate	7.98%	0.85%
HRA Contribution Rate	N/A	3.00%
Total	10.95%	9.23%

* Based on results as of June 30, 2007. Updated results as of June 30, 2008 will be ready in the next few weeks.

Teachers' Retirement System	DB Plan Tier 2	DCR Plan Tier 3*
DB Plan Employer Normal Cost Rate	2.71%	N/A
DC Employer Contribution Rate	N/A	7.00%
Occupational Death and Disability Normal Cost Rate	N/A	0.32%
Medical Normal Cost Rate	6.25%	1.08%
HRA Contribution Rate	N/A	3.00%
Total	8.96%	11.40%

* Based on results as of June 30, 2007. Updated results as of June 30, 2008 will be ready in the next few weeks.

For both PERS and TRS, the normal cost rate of the DB plan is less than the DC employer contribution rate.

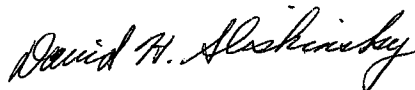
There are other factors to consider, not just cost, when comparing the DB and the DCR plans. One of the fundamental differences between a defined benefit and defined contribution plan is who bears the risk. The risk, whether investment risk or mortality risk, is borne by the employer in a DB plan. This risk causes volatility over the short-term in determining the annual cost that will sufficiently meet the long-term benefit obligation. The employer contribution rates for the DB plan shown in this letter represent the expected long-term cost of the DB plan benefits. When experience is different than assumed from one year to the next, hence short-term volatility, the employer contribution rates change. The employer contribution rates in the DCR plan are not subject to this short-term volatility since the members bear most of the risk. As a result, employer contribution rates are stable and not subject to volatility.

DATA, ASSUMPTIONS, METHODS AND PROVISIONS

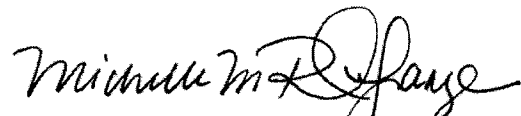
The data, assumptions, plan provisions and methods used for the DB plan costs are described in the draft actuarial valuation reports as of June 30, 2008. The postretirement healthcare and occupational death and disability rates shown for the DCR plan costs are based on the June 30, 2007 valuation of the DCR plan. The assumptions, methods and provisions used for the DCR plan costs are the same as those outlined in our previous letter sent to Pat Shier on April 29, 2008. The actual FY11 DCR rates will be finalized soon.

Please let me know if you have any questions or if we can be of further assistance.

Sincerely,



David H. Sliskinsky, ASA, EA, MAAA
Principal, Consulting Actuary



Michelle Reding DeLange, FSA, EA, MAAA
Director, Retirement Actuary

/mip

c: Ms. Kathy Lea, State of Alaska
Mr. Kevin Worley, State of Alaska
Mr. Chris Hulla, Buck Consultants
Ms. Kyla O'Rourke, Buck Consultants

**The New Intersection on the Road to Retirement:
Public Pensions, Economics, Perceptions, Politics, and Interest Groups**

Beth Almeida, Kelly Kenneally, and David Madland

September 2008

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Pension Research Council Working Paper
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**The New Intersection on the Road to Retirement:
Public Pensions, Economics, Perceptions, Politics, and Interest Groups**

Beth Almeida, Kelly Kenneally, and David Madland

Abstract

State and local pensions have been a cost-effective way to ensure that those retiring from public service will have adequate retirement income after a lifetime of work. Despite their strengths, opposition to public pensions has emerged in recent years. This chapter examines the economics of public pensions and outlines the role of public perceptions, politics, and interest groups in the public pension debate.

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The New Intersection on the Road to Retirement: Public Pensions, Economics, Perceptions, Politics, and Interest Groups

Beth Almeida, Kelly Kenneally, and David Madland

U.S. state and local pension plans have served as the cornerstone of retirement security for generations of teachers, police officers, firefighters, and other public servants for the last century. State and local governments continue to offer secure pension benefits to some 20 million workers and retirees, or 12 percent of the nation's workforce. As a group, these systems offer a cost-effective way to recruit, retain, and retire the workforce needed to deliver essential public services. But despite the strengths of the system, opposition to state and local pensions has emerged in recent years. Legislatures in several states including Alaska, California, Colorado, and Utah, have considered proposals that would drastically change how public employee retirement systems function. This chapter considers the question of how perceptions, politics and interest groups – rather than sound economic and policy analyses – are shaping public pensions.

We begin with an overview of how state and local pension systems ensure retirement income adequacy for public employees and discuss how these systems are financed. We contrast the successful model of state and local pension systems with trends in the private sector toward increasing insecurity in retirement. We then turn to a discussion of how the public views pensions and the factors that drive public opinion on this issue. Finally, we examine the role that politics and ideological interest groups are playing in state policymaking and the overall public pension debate.

Public Pensions and Retirement Living Standards

Retirement security trends in the U.S. are troubling. Retirement plan coverage is declining in the private sector, personal savings are non-existent for most households, and six in 10 Americans are at risk of being unable to sustain their standard of living in retirement (Purcell 2007; Bureau of Economic Analysis 2008; Munnell, Soto et al 2008*b*). But in the midst of this gloomy picture, there is a beacon of light: employees in the public sector are generally well positioned for a secure retirement, and state and local retirement systems stand out as a notable success story.

Traditionally, state and local employees are very likely to have access to at least one retirement plan at work and their primary plan is almost always a defined benefit (DB) pension plan. Three-quarters of state and local employees have a retirement plan, and of these, the majority, 86 percent, were covered by a DB plan (in 2004; Munnell, Haverstick and Soto 2007). In a typical public sector DB plan, employees earn a benefit based on years of service and career-end salary (usually an average of the final three years' salary). The median benefit for Social Security-eligible public employees is 1.85 percent for each year of service. This means that after working 30 years, an employee would be eligible for a pension that would replace 55.5 percent of final earnings – an amount that, when added to Social Security and private saving, should meet generally-recognized standards of retirement income adequacy.¹ It is important to note that about one-fourth of state and local employees do not participate in Social Security. For these groups, the median pension formula is higher – 2.2 percent per year of service – which provides a benefit equal to 66 percent of final earnings after 30 years (Brainard 2007).

Almost all state and local employees also have the opportunity to participate in defined contribution (DC) plans, which in the public sector are known as 457(b) plans and/or 403(b)

plans. Most states that offer a DB plan also offer a voluntary DC plan as a supplement, but participation rates tend to be low (GAO 2007a). For example, just six percent of state and local employees participated in both a DB plan and a supplemental DC plan in 2004 (Munnell, Haverstick and Soto 2007). Low rates of voluntary participation could reflect the fact that public employees typically make substantial contributions to their DB plans, a fact which will be discussed further below.

In a DC plan, benefits in retirement will depend on various factors including the amount contributed by employer and employee; the length of time funds remain in the account; whether funds are withdrawn; the amount of investment earnings; and the fees charged to the account. In a typical DC plan, there is a high degree of employee direction. The employee must decide how much to contribute (if at all), how to invest the funds, and how to make changes to these factors over time. Well-designed DC plans can be helpful supplements to DB plans, as they allow employees to save additional funds for retirement on a tax-advantaged basis that is in line with their own unique needs and circumstances. But DC plans can be problematic when they serve as the primary retirement vehicle, since workers generally fail to save enough, make poor asset allocation and investment decisions, cash out their accounts when they change jobs, and are reluctant to annuitize retirement wealth accumulated, even when doing so could enhance their well-being (Mitchell and Utkus 2004; GAO 2007b).

The state of Nebraska is a high-profile example of a public sector employer that for more than three decades offered a DC plan as the primary retirement plan to a large number of public employees, while it offered other state employees a DB plan. Yet that state found that the DC plan was not adequate to ensure that all workers would have sufficient retirement income, so in 2003 it established a new cash-balance DB plan for employees who otherwise would have had to

rely only on the DC. This was done after concluding: “We have had over 35 years to ‘test’ this experiment and find generally that our defined contribution plan members retire with lower benefits than their defined benefit plan counterparts” (House Committee on Pensions and Investments 2000, p. 32). These and other research findings suggest that DB plans are a key component of a retirement system that seeks to ensure that employees will have sufficient assets to meet their needs in retirement (Engen, Gale and Uccello 2005; Munnell, Webb and Delorme 2006).

Because of their widespread access to DB plans (and in many cases, supplemental DC plans), most workers in state and local government have a good chance to earn retirement benefits that allow them to maintain a middle-class standard of living even after they stop working.² Retirement assets per worker in public sector retirement plans are more than two times greater than those in private sector plans (Munnell, Haverstick and Soto 2007). The median public sector retiree receives a benefit of \$22,000 per year. This amount, when combined with other reserves such as Social Security and/or private savings, provides middle-class teachers, public safety workers, and other public workers with the ability to maintain their living standards in retirement (McDonald 2008).

Public Pension Plans are a Fiscally Responsible Way to Finance Retirement

The financing of state and local pensions is a shared responsibility between the employer (taxpayer) and employees. This is a key difference between DB plans in the public sector as compared to the private sector. In the private sector, the financing of promised benefits is typically the sole responsibility of the employer. Social Security-eligible public sector employees typically contribute five percent of pay to their pension plans, while non-Social Security eligible

employees contribute 8.5 percent (Brainard 2009). This model of cost-sharing is viewed positively by taxpayers, according to public opinion surveys to be discussed below.

State and local pension DB plans tend to be funded rather than financed on a pay-as-you-go basis. Employer and employee contributions to these public pension plans are pooled in a trust and invested. The earnings on these investments help finance the benefits which eventually are paid out (Steffen 2001). In fact, investment earnings pay for the greatest share of benefits earned in public sector DB plans. Over the past decade, almost three-fourths of the funds that have flowed into state and local pension plans have been investment earnings. Only about one fifth came from employer (taxpayer) contributions, and the remainder came from employee contributions (Authors' calculation based on data from U.S. Census Bureau 1996-2006).

Because of their group nature, public sector DB plans create significant economies for taxpayers and employees. Investment decisions in these plans are made by professionals, whose activities are overseen by trustees or other fiduciaries. This is in contrast to most DC plans where individuals often make poor investment decisions, where their inertia subjects their portfolios to acute imbalance, or at the other extreme, where engagement in excessive trading results in "buying high and selling low" (Mitchell and Utkus 2004; Munnell and Sunden 2004). By contrast, public pension plan managers follow a long-term investment strategy (Weller and Wenger 2008). By pooling assets, DB plans can drive down administrative costs and reduce asset management and other fees (Hustead 2009). Asset management fees average just 25 basis points for public pension plans. By comparison, asset management fees for private 401(k) plans range from 60 to 170 basis points (Munnell, Haverstick and Soto 2007). Because of these two effects, professional investment management and lower fees, it should not be surprising that professionally managed DB plans consistently outperform individually managed DC plans. One

widely-cited estimate puts the difference in annual return at 0.8 percent (Munnell and Sunden 2004). Over a 30 year time period, this would compound to a 25 percent difference in total return.

DB plans create additional economies for participants and plan sponsors by pooling mortality and other risks. Mortality risk refers to the fact that an individual does not know his ultimate life-span, which makes it extremely difficult to know exactly how much is needed to be certain that one will not outlive those savings. In a system of individual accounts, each person must accumulate enough saving to last for the maximum lifespan. By pooling the mortality risks of large numbers of people, DB plans need only accumulate assets sufficient to fund the *average* life expectancy. Thus, a DB plan will require fewer assets to be accumulated than a comparable DC plan, reducing costs by 15 percent to 35 percent (Fuerst 2004).³ By combining the effects of professional management, lower fees, and risk pooling, actuaries have determined that DB plans are much more efficient than DC plans and that they provide pension benefits at a far lower cost (Fuerst 2004; Waring and Siegel 2007). Thus, to the extent that public retirement systems are supported (at least partially) by taxpayer funds, a DB plan design supports the goal of fiscal responsibility (Hustead 2009).

Despite their financial advantages, state and local DB plans have attracted attention from policymakers, researchers, the media, and others in recent years, because average funding levels had been on the decline, and in some cases, because of rising contribution requirements (GAO 2007a). As we will discuss in greater detail, DB plan funding levels have become a central focus of interest groups and others who seek to replace these plans with DC plans. Clearly, DB plans' funded status tends to ebb and flow over time with the ups and downs of asset markets, interest rates, and other macroeconomic factors. The funded status – the ratio of existing plan assets to

the totality of current and future benefits – of state and local DB plans fell in the wake of the downturn in asset markets at the beginning of the 2000 decade, just as it did for DB plans in the private sector and other institutional investors. Prior to the downturn, public sector plans as a group had reporting being fully funded (Brainard 2004). Of course there were exceptions to this general rule; a GAO (2008) study reported that while most plans were soundly funded, “a few have been persistently underfunded.” It concluded, “Governments can gradually recover from these [stock market] losses. However, the failure of some to consistently make the annual required contributions undermines that progress and is cause for concern ...” (GAO 2008, p. 26). In other words, regardless of the type of plan (DB or DC), if a plan sponsor postpones paying for it, the bill will grow and become more expensive to pay when it finally comes due.

For a solvent public plan sponsor, it may be neither critical nor particularly important for the DB pension to be constantly “fully funded.” This is because a DB pension has a long time horizon, since benefits earned by participants in the plan do not have to be paid immediately. As a result, many DB plans take the long view, especially for public DB plans because they are backed by government entities that (unlike private corporations) have a very low risk of insolvency. In this instance, periodic swings in the plan’s funded status can be viewed as a normal and expected feature. Cyclical downturns tend to be followed by improvements in asset markets, a phenomenon that economists describe as “mean reversion” (Poterba and Summers 1988). Indeed, as asset returns have recovered and contributions increased in recent years, the average public plan’s funded status has improved. In fiscal year 2006, for instance, the average plan was 85.8 percent funded (Brainard 2007). The GAO reports that “a funded ratio of 80 percent or more is within the range that many public sector experts, union officials, and advocates view as a healthy pension system” (GAO 2007a, p. 35).

Proper Funding may be Harder to Achieve in Defined Contribution Plans

Some argue that the routine swings in funding that DB plans experience create untenable volatility in contributions for plan sponsors, but this is not necessarily the case. Disciplined funding practices and rules that reflect the going concern nature of DB pension plans can reduce the funding volatility of a pension plan, especially for public sector plans (Weller and Baker 2005; Weller, Price and Margolis 2006; Giertz and Papke, 2007). DC plan advocates also claim that because of the nature of the employer commitment in a DC plan (the employer simply commits to making a contribution rather than promising a certain benefit), such plans are always “fully funded.” However, it is important to recognize that “underfunding” *can and does* exist in a DC system, but it takes a different form. That is, when individuals compare the actual level of assets in their DC plan to what would be required to support an adequate retirement, they may find that their retirement needs are seriously underfunded.

From this perspective, the level of underfunding in DC plans is striking. According to the GAO, workers age 55-64 had a median account balance of \$50,000 in 2004. If this were converted into an annuity at age 65, such an amount would provide an income of only \$4,400 per year (GAO 2007b). Moreover, the GAO identified gaps in workers’ ability to accumulate adequate retirement assets in DC plans, gaps that do not exist to the same degree with DB plans where participation typically is mandatory. That report concluded: “DC plans can provide a meaningful contribution to retirement security for some workers but may not ensure the retirement security of lower-income workers” (GAO 2007b, p. 2).

This GAO 401(k) plan study stands in stark contrast to the agency’s recent study of public sector DB plans, which concluded that the latter are generally on track to being fully

funded. GAO found that the projected fiscal impact of fully funding pension obligations will be modest, so that state and local governments will be able to meet their future commitments with just a modicum of effort: “Estimated future pension costs (currently about 9 percent of employee pay) would require an increase in annual government contribution rates of less than a half percent” (GAO 2007a, p. 2). To fill the gap in retirement wealth for DC plans, most researchers estimate substantially larger increases in contribution rates would be required (VanDerhei 2006).

How the Public Perceives Pension Plans

Despite the health of public sector DB plans, legislatures in several states including Alaska, California, Colorado, and Utah, have recently considered whether to transition from a DB to a DC-only system. This may be because public policy debates can be driven by perceptions, politics, and interest groups rather than economic factors. We turn next to an evaluation of public opinion on the merits of DB plans compared to DC plans. As we shall show, the public’s knowledge base is low; the public is divided about which one of the two systems is better; and judgments about the merits of one type of plan over the other are driven largely by ideological concerns and self-interest.

Low Knowledge Base. The U.S. public does not know much about different types of pension plans. One survey showed that 40 percent of respondents said they have little knowledge of either 401(k) plans or DB plans (Hart 2006). Workers also know relatively little about their own retirement plans (Mitchell 1988; Gustman and Steinmeier 1989; Reynolds, Ridley and Van Horn 2005; Lusardi 2007). Further, a substantial minority of people will not even venture a guess as to the type of plan in place (Reynolds, Ridley and Van Horn 2005). Perhaps the most striking evidence of the low level of knowledge is that only half of older workers could correctly identify

whether they had a DB, DC, or combination plan (Gustman and Steinmeier 2004). As a result, expressed opinions about different types of pension plans should be seen against the very low level of information for most members of the public.

Public Opinion Divided on the Relative Merits of DB and DC. Little research exists about the public's preferences for DB or DC plans (Madland 2007). Available research indicates that, if forced to choose, people are evenly split about the merits of each type of plan. For example, in two nationally representative surveys, one found a slight preference for DBs but the other found a slight preference for DCs. (The question wording appears to explain the difference in the results.) A June 2005 Heldrich Center for Workforce Development at Rutgers University survey of 800 people currently in the workforce asked whether workers would prefer to receive their retirement benefits "based on salary and years of service" or based on "how much money is in the account." A slight majority (51 percent) said they would prefer to receive retirement benefits based on salary and years of service, while 37 percent would prefer to do so based on how much is in the account, with 11 percent unable or unwilling to answer. A 2006 survey of 804 registered voters conducted by Hart Research Associates asked: "which is generally the better overall kind of retirement plan for workers – a pension plan or a 401(k)-type saving plan?" A slight majority (52 percent) answered that a 401(k) is better for workers, while 33 percent said a pension plan is better, with 15 percent unsure or unable to decide. This latter survey also asked what type of retirement plan public employees should have. Results are similarly divided. When asked about "proposed change from pensions to 401(k)s for public employees, 47 percent of voters strongly or somewhat opposed the plan, 44 percent of voters strongly or somewhat favored the proposal, and 9 percent said they were unsure.

Public Opinion Driven By Ideology and Self-Interest. Why people prefer one type of retirement plan over another is likely guided by the same forces that drive public opinion on a range of other economic policies: ideology and self-interest. Public opinion research commonly (although not always) finds that self-interest shapes how people think about economic policy questions (Blekesaune and Quadagno 2003; Cook and Barret 1992; Hasenfeld, Yeheskel and Rafferty 1989; Ponza, Duncan, Concoran and Groskind 1989). If people believe that a policy will personally benefit them, they are more likely to support it. As a result, we should expect that, for example, government employees would be more likely to oppose switching public DB to DC plans. In fact, public employees should be especially likely to support DB plans because unions and other organizations communicate with them about the benefits of keeping such plans in the face of policy proposals to switch to DC plans. When organizations publicize issues, they prime people to think about the personal costs and benefits of an issue, making it more likely that people recognize their own self-interest and take action (Chong, Citrin and Conley 2001).

Demographic factors such as age, income, and education, also help determine whether people believe that a given policy is in their self-interest and thus these factors also affect their policy preferences (Blekesaune and Quadagno 2003; Cook and Barret 1992; Hasenfeld, Yeheskel and Rafferty 1989; Ponza, Duncan, Concoran and Groskind 1989). Ideology also is often theoretically and empirically linked to policy preferences (Hartz 1955; Schlozman and Verba 1979; McClosky and Zaller 1984; Feldman and Zaller 1992; Hasenfeld and Rafferty 1989; Cook and Barret 1992; Blekesaune and Quadagno 2003; Madland 2007). Americans tend not to have fully-fledged ideologies where every issue position matches a basic principle, and they tend to be rather ambivalent about their ideological leanings (Converse 1962; Feldman and Zaller 1992; Hochschild 1981; Free and Cantril 1968; Madland 2007). Nevertheless, Americans do

have ideological leanings towards an individualistic, self-reliant ethic (Hartz 1955; Schlozman and Verba 1979), especially when compared to people in other countries. For example, surveys find that people of other nationalities are more likely to believe the government is responsible for providing a secure retirement, while Americans tend to believe they are personally responsible. A recent AARP poll found that half of all Americans believe individuals are responsible for themselves in retirement, compared to fewer than 40 percent of British and Germans, and fewer than 20 percent of French and Italians (AARP 2005).

While Americans may be more individualistic than other nationalities, they are not totally opposed to more collective solutions for retirement, supporting a division of responsibility between individuals, government, and employers for retirement savings. When asked in the 2005 Heldrich poll: "Who do you think should be primarily responsible for helping workers prepare for retirement? Workers, employers or the government?" some 39 percent of those surveyed said workers, 25 percent employers, and 18 percent government. Seventeen percent volunteered that all three should be responsible.

A related question in the 2006 Hart poll found similar results. The Hart survey asked: "Do you personally think that being able to retire with financial security is a right that society should protect for all working people, or a personal goal that people are responsible for achieving on their own?" Forty seven percent of voters answered that retirement is "a personal goal that people are responsible for achieving on their own," while 39 percent answered that "being able to retire with financial security" is a "right for all working people." Eleven percent of people surveyed answered "both" – a choice that respondents had to volunteer on their own.

Ideological leanings would also seem likely to shape people's preferences for DB or DC plans. People who believe that the right way to live in retirement is to depend upon themselves

rather than the government or the employer would be predicted to prefer DC over DB plans. A quick comparison of ideology and pension plan preference supports this expectation, and it shows that people who think individuals should be responsible for their own retirement are about 50 percent more likely to prefer DC plans than people whose ideology is not as individualistic.⁴

The expectation that ideology and self interest influence how people think about DC and DB plans is tested more rigorously in the three regression models presented in Table 1 below, using data from the Heldrich (2005) and Hart (2006) public opinion surveys. Both surveys were nationally representative. The explanatory variables in each model include age, sex, education, income, union status, employment sector (public or private), the type of retirement plan a person has, and indicators of ideology and political party. Women appear to prefer interventions in the economy (Alvarez and McCaffery 2003) and thus are expected to be more supportive of DB pensions. For partisan identification, a concept closely interrelated with ideology, people who identify with the Republican Party are less likely to support economic intervention and thus would be expected to be less supportive of DB pensions (Cook and Barret 1992; Hasenfeld, Yeheskel and Rafferty 1989). Members of labor unions are more likely to support policies to ameliorate perceived flaws in the market, both because of their group interest as well as the greater likelihood that union leadership has framed the issue and communicated it to them (Nelson and Kinder 1996; Glasgow 2005). Finally, people's own experience with a DB or DC plan may shape their preferences, with people tending to support the kind of plan they have because they are more familiar with it. The dependent variables measure people's preferences for DB or DC plans for themselves and government employees, as described above.

Table 1 here

The results indicate that ideology and self-interest are very strong predictors of people's opinions about DC and DB plans. People who believe in an individualistic ideology are much more likely to support DC plans, while people who work in the public sector are less likely to do so. In fact, these two variables – individualistic ideology and working in the public sector – are the only variables that are statistically significant in all three models. The result that ideology and self-interest drive public opinion about retirement plans is robust and holds up in alternative specifications. All other variables that are statistically significant in any of the models – such as women opposing changing public employee pensions to 401(k) plans – are in the predicted direction.

These results suggest that where voters and policy makers are predisposed to a particular ideological viewpoint, they may be swayed as much by political considerations as economic ones when it comes to making decisions about the ideal design of public pensions. Next, we turn to examine how political forces have played out in recent debates about the future of public pensions.

The Role of Politics & Interest Groups in the Public Sector DB Debate

Given that there does not appear to be a groundswell of public concern about DB plans, and taking into account the public's lukewarm impressions on retirement plan design, an obvious question arises: why have public sector DB plans become a political battleground in some states? One explanation is that partisan politics may play a role. Another explanation is that interest groups ideologically predisposed to more individualistic approaches to retirement may have been able to generate enough political momentum to raise the design of public sector pension plans as a public policy issue, despite the overall sound financial footing of public pensions. In this

section, we first explore the issue of partisan views on retirement policy. We then provide an overview of some key interest groups that have focused on public pensions and highlight their role in recent state initiatives to convert public sector DB plans to DC plans.

Partisanship and Pensions. There is evidence that politics has been a key factor in recent debates on public sector DB plans. Munnell et al. (2008a) statistically examine the question of why some states have adopted DC plans as a primary plan, while others have not. They find that Republican control of the governorship and the state legislature is the greatest single predictor of whether a state made the switch to a DC plan. Other influential factors included union presence and sizeable employee pension contributions, both of which tended to reduce the likelihood of DC adoption. Surprisingly, other factors like lack of Social Security coverage and the plan's funded status did not have a statistically significant effect on whether a plan made a switch to DC. This finding is reinforced in the case studies presented below. In Utah, California, and Alaska, the pension systems were all more than 80 percent funded, yet proposals were made (and in Alaska, adopted) to convert the system to a DC plan.

One explanation for these findings is that Republicans typically support DC plans because employees control the investments. DC plans are consistent with that party's political philosophy of individual responsibility for retirement savings. Thus, when Republicans are in control, changes or attempts at changing the nature of public pensions have been seen. (Munnell et al 2008a). However, the results from our analysis of opinion research indicate a paradox; individual Republicans are no more likely to support a switch to DC, after controlling for other factors (see Figure 1).

Figure 1 here

Interest Groups and the Public Sector DB Debate. Another factor that has received less attention from researchers is the role of interest groups in advocating for changes to public pension systems. An interest group can be defined as an organized body of individuals sharing goals and who try to influence public policy (Berry 1989).

Throughout American history, interest groups have played a role in American politics. During the New Deal, the role of business interest groups was seen to influence policies that led to the formation of regulatory agencies. More recently it has been suggested that interest groups are growing too strong: one study showed the number of new interest groups grew 30 percent from 1960-80 (Berry 1989). Another study found a similar pattern, showing that 40 percent of interest groups were founded after 1960 and 25 percent after 1970 (Berry 1989). Both surveys showed that citizen groups were likely to have formed recently and confirmed that the increase is not a function of exaggerated rhetoric about the perils of modern interest groups.

Today's interest groups engage in a wide variety of activities. They may lobby branches of government at the local, state, or federal level. They also may seek to educate the American public or policymakers about issues, but they typically present only their side of an issue, offering facts and interpretations most favorable to their position. They are also active in agenda building: that is, interest groups frequently are responsible for bringing attention to their issue or position. These groups are consistent in pushing government to develop policies that, while advantageous to their own small constituency, do not benefit the broader public (Berry 1989).

In recent years, national and state-based interest groups have become key players in challenging the continuation of public sector DB plans and advocating a switch to DC plans. Tom Lussier, a former Massachusetts state legislator and pension system executive director, provided insight on the evolution of interest group involvement in public pensions. He indicated

that, prior to the 1980s, state and local pensions were not on the radar screen of interest groups. But as public DB plans began investing in equities and the assets began to grow significantly, the plans became a target of interest groups active in pursuing anti-tax, free market, and individual responsibility/savings philosophies. These philosophies often did not take into consideration the economic benefits and efficiencies of public pensions (Lussier 2008).

The agenda pursued by these anti-tax, free market groups is perhaps best summed up by Grover Norquist, of the interest group Americans for Tax Reform (ATR). He said of public sector DB plans, “just 115 people control \$1 trillion in these funds. We want to take that power and destroy it.” (Dreyfuss 2001, p. 16). Norquist and his group view public DB pensions as a battleground issue and they have actively planned state-by-state campaigns to dismantle public pension plans (Dreyfuss 2001). In recent years, likeminded groups including the American Legislative Exchange Council, Americans for Prosperity, the Club for Growth, the Manhattan Institute, and the Reason Foundation have sought to influence public opinion with reports, briefing papers, opinion pieces and model legislation advocating DC over DB plans.

American Legislative Exchange Council. Founded in 1973, the American Legislative Exchange Council (ALEC) is a membership association for conservative state lawmakers who share “a common belief in limited government, free markets, federalism, and individual liberty” (p. 5). The organization generates research, policy papers and model legislation covering various issues before state governments (ALEC 2008a).

In 2000, ALEC published an issue paper which argued that public employees should have access to 401(k) plans (Lathrop and Singer 2000). The paper did not acknowledge that access to DC plans was already widespread for state and local employees. Additionally, ALEC offered model legislation to state legislators promoting DC plans for public employees as a replacement

for DB pensions (ALEC 2008b). This model legislation was introduced in Florida in 2000; though it was not adopted, the Florida legislature did enact a DC option for public employees (Lathrop and Singer 2000). The sponsor of the legislation, State Representative Ken Pruitt, was awarded ALEC's "Hero of the Taxpayer" award winner. Pruitt also was nominated by ATR for ALEC's legislator of the year award. An ATR press release said that Pruitt was "boldly paving the way for similar reforms across the country" (ATR 2000).

Americans for Prosperity. Americans for Prosperity is a Washington, D.C. non-profit organization that engages citizens to promote limited government and free markets on the local, state, and federal levels. The organization describes itself as working to educate citizens about economic policy and mobilizing citizens as advocates in the public policy process (Americans for Prosperity 2008). The organization has proposed closing down DB plans in favor of DC plans for public employees on the grounds that the latter are "fairer to employees, employers, and taxpayers – and they do not incur unfunded liabilities" (Poulson 2006). The organization became involved with efforts in Colorado to change the public retirement system from DB to DC, to be discussed below in greater detail.

Americans for Tax Reform. ATR is a national non-profit lobbying organization established to oppose tax increases founded in 1985 by Grover Norquist. It serves as a national clearinghouse for a taxpayers' movement by working with approximately 800 state and county level groups. In recent years, ATR also has been active in efforts to privatize Social Security (ATR 2008). ATR's former chief economist Daniel Clifton has stated that the organization fully supports moving to a system of DC plans for state and local employees (Clifton 2004). A 2002 ATR policy brief on pension reform argues that states should move aggressively to transfer all state and local employees and schoolteachers from DB to DC plans to "make full scale pension liberation a

reality” (Ferrara 2002). The brief further argues that DC plans allow workers to earn higher benefits than traditional pension plans, save the employer administrative and funding costs, and help public employers recruit the best workers. In practice, DC plans have pitfalls when they are used as a primary retirement vehicle and often provide lower returns for workers, they are typically more expensive for employers for any given level of benefit, and they already are available as supplements to almost all public employees who desire to participate in them, facts not noted in ATR’s writings on public pensions. Nevertheless, ATR endorsed DB to DC switch initiatives in California, and its reports were used to justify a successful proposal in Alaska to switch to a DC plan (Persily 2005a; Broder 2005).

Club for Growth. Established in 1999, this organization seeks to advance public policies that promote economic growth primarily through legislative involvement, issue advocacy, research, training, and educational activity. Its policy goals include cutting taxes, limiting government spending, and privatizing Social Security. The organization has a related political action committee that makes campaign contributions to candidates running for office, specifically in Republican primaries (Club for Growth 2008). Through its campaign-related activities, the Club for Growth actively supports Republican candidates looking to unseat moderate Republicans that the group deems at odds with its anti-tax, limited government agenda (Dewar 2004).

The Club was a particularly determined supporter of President Bush’s 2005 campaign to overhaul Social Security by adding individual private accounts and spent millions to lobby on its behalf (Bailey 2005). The Club for Growth also was involved with the California pro-DC initiative, with a former director advocating for a DB to DC switch (Broder 2005). More recently, as part of its evaluation of candidates vying for the Republican presidential nomination, the group singled out former Massachusetts governor Mitt Romney, praising him for “proposing

to revolutionize the Massachusetts state pension system by moving it from a DB system to a defined contribution system” (Club for Growth 2007, p. 5).

The Howard Jarvis Taxpayers Association. Founded in 1978, the Howard Jarvis Taxpayers Association is dedicated to the protection of Proposition 13, the California measure to cap property taxes, and the advancement of taxpayers' rights. This includes the “right to limited taxation, the right to vote on tax increases and the right of economical, equitable and efficient use of taxpayer dollars.” (Howard Jarvis 2008). This organization in 2005 indicated that it planned to put the DB to DC issue on the California ballot through the initiative process (Associated Press 2005b). In 2007, the organization issued a study asserting that “California's pensions are getting shakier” (Taub 2007), while CalPERS and CalSTRS disputed the findings. CalPERS called the report “a highly contrived, biased study that fails to show the big picture” that “hinged on a “snapshot” view of activity artificially constrained to a period of market downturn and the early stages of its recovery” (Taub 2007).

The Manhattan Institute. Established in 1978, the Manhattan Institute is a non-profit organization that aims to develop policy ideas that foster economic choice and individual responsibility (Manhattan Institute 2008). In a 2003 report entitled “Defusing the Pension Bomb: How to Curb Public Retirement Costs in New York State,” Manhattan senior fellow E. J. McMahon contended that greater fairness for taxpayers and better retirement benefits for most government employees can be achieved by switching from the current DB pension system to a DC model. McMahon justified the DC approach in part by noting it is used by the vast majority of private companies (McMahon 2003). However, no discussion of the adequacy of these plans in the private sector was attempted.

A 2007 opinion piece by McMahon in the *Wall Street Journal* called into question DB pensions and voiced support for 401(k)-type plans for the public sector (McMahon 2007). A response letter to the editorial by the presidents of organizations representing state and local retirement administrators and trustees called the piece “remarkably uninformed” about public pensions. In the letter, the signatories noted that the column failed to acknowledge that public pensions collectively are well funded, overseen by capable trustees, and subject to stringent laws, regulations, audits and public oversight. The letter also noted that the column ignored that DB pension funds generate higher investment returns than 401(k) plans, portability has been built into public pensions, and that when offered a choice, the majority of public employees have eschewed DC plans and elected instead to participate in the DB benefit plan (Hanes and Williams 2007).

Reason Foundation. Founded in 1968, the Reason Foundation is a non-profit organization focused on advancing a free society by developing, applying, and promoting libertarian principles. Reason’s website indicates that the *Wall Street Journal* says about the Reason Foundation, “Of all the nation's conservative or free-market policy groups, it may be the most libertarian among them...and its ends up having the most direct impact on the actual functioning of government” (Reason Foundation 2008).

In June 2005, the Reason Foundation issued a report entitled, “The Gathering Pension Storm: How Government Pension Plans are Breaking the Bank and Strategies for Reform” (Passatino and Summers 2005). The report characterizes pension benefits earned by public employees as “extravagant” (p. 4), “exorbitant” and “unsustainable” (p. 5), but nowhere references data on actual levels of public pension benefits. It highlights the experience of a handful of examples of public plans that were experiencing significant funding challenges, then

generalizes these exceptions to claim, “Government employee pension systems across the nation are in crisis” (Passatino and Summers 2005, p. 3). In fact, at the time of the report’s publication, public retirement systems were on average 85% funded (Brainard 2005). The national association representing state retirement administrators issued a response rebutting Reason’s analysis point by point (Brainard 2006b). Reason’s report urged all governments to shift new employees to 401(k)-style defined-contribution plans, remarking that in addition to purported economic benefits of this proposal, the “*moral* benefit is that it allows employees the freedom to manage their own retirement accounts and invest their own money as they see fit” (Passatino and Summers 2005, p. 5). More recently the Foundation continues to advocate a switch from DB to DC. In its March 2006, “Budget and Tax News,” the organization again indicated that the public pension “crisis” has worsened, that taxpayers should worry, and that the problem is nationwide (Summers 2006).

Common Themes. Although each of the interest groups described above is a distinct entity, there is overlap in arguments made to support a switch to DC plans. Appeals to the supposed benefits of individual control over retirement decisions are frequent, as are claims that current DB plans are overly generous. Each of these groups also tends to suggest that failing to adopt DCs will result in dire consequences. For example, the term “crisis” and the metaphor “time bomb” are used frequently. Despite the fact that many of their claims are at odds with reality, we will illustrate in the next section that these interest groups have been surprisingly successful at creating an audience for their proposals, though it may be limited to those who share their free-market, individualistic ideology. This may be one reason why interest groups have had mixed success in actually achieving their legislative goals.

Recent Attempts to Convert Public DB to DC Plans.

We now turn to an examination of recent attempts in four states to convert traditional DB to DC plans. We will see that in each case, partisan politics and/or interest groups have had a hand in triggering policy proposals and driving the political debate around public pensions.

Alaska. In 2005, Alaska Republican Governor Frank Murkowski signed legislation switching the state's DB pension retirement systems to 401(k)-type DC accounts for teachers and state employees hired after July 1, 2006 (Inklebarger 2005). The DC individual account system is the only retirement plan for public workers, as Alaska's state and local employees do not participate in Social Security. At the time the legislation was enacted, the Alaska Public Employees Retirement System provided retirement benefits to about 53,000 workers and retirees such as police officers and firefighters serving the state and 155 municipalities (Brainard 2006a). It also impacted the Alaska Teachers Employee Retirement System (TRS) which opened in 1955. In 2005, TRS included about 18,000 active and retired teachers and other education professionals in 57 school districts (Brainard 2006a).

The DC measure, introduced by Republican State Senator Bert Stedman, was "one of the most contentious in the legislature" and one of the main issues during a two-week special legislative session (Inklebarger 2005). The special session debate – at a time when Republicans controlled the legislature – was characterized as "a nasty fight" over whether to end pensions for new public employees and teachers (Cockerham 2005a, p. A1). Consideration of the measure coincided with a push by the Bush Administration to privatize Social Security. The White House reportedly became engaged in the Alaska pension battle when Alaska Senate President Ben Stevens contacted the White House to report problems securing votes to eliminate the DB system for public employees in Alaska. According to the *Anchorage Daily News*, a White House official

phoned several Republican House members “reminding them that President Bush's vision of Social Security reform is similar to the proposed overhaul of retirement benefits for Alaska's teachers and other public employees” (Persily 2005b, p. A1). The aide reportedly indicated that “if legislators support the President, and support converting a portion of Social Security payroll contributions to private accounts, then it makes sense they would favor a similar system of individual investment accounts for Alaska public employees” (Persily 2005b, p. A1).

The measure also was reported to have roots back to Americans for Tax Reform. Democrats pointed out that the Senate Finance Committee’s report on the pension legislation was “lifted from a policy brief” by ATR (Persily 2005a, p. B1). Both the policy brief and the Senate Finance report “tout the benefits of switching public employees from traditional pension plans to individual savings accounts, similar to the president's arguments for changing Social Security.” Of the connection, Senate Minority Leader Johnny Ellis said he had the sense that the measure was “part of a national conservative movement that is detrimental to public employees” (Persily 2005a, p. B1). Senate Finance Co-Chair Lyda Green reportedly denied “a national political conspiracy,” but also indicated that there was nothing wrong if the committee report came from a conservative web site saying, “I'm not going to apologize for it” (Persily 2005a, p. B1).

The House and Senate had separate proposals to address the retirement system at a time when Alaska's public pension funds had pre-funded some \$13 billion in assets to pay for future costs. Similar to other public retirement systems, funding levels were lower in 2005 due to the market downturn in the early 2000s. The *Anchorage Daily News* reported that Alaska had one of the best-funded retirement systems in the country, and there was “no good evidence that ending

the pensions” would address current funding issues, and calls for more research on the issue (Cockerham 2005b, p. A1).

According to the former Alaska Division of Retirement and Benefits Director Melanie Millhorn, the pension shortfalls were due mainly to rising health care costs and a downturn in investments. The state Office of Management and Budget indicates that in 2001 and 2002, the fund’s investments lost about 5 percent of their value. However, from 1999-2001, the medical costs, which were expected to rise between 5 and 6 percent, actually rose between 15 percent and 20. “If it weren't for rising health care costs, the pensions would be more than fully funded,” Millhorn said (Volz 2005).

Meanwhile, Sam Trivette, president of the Retired Public Employees of Alaska, also stated that the main cause of the shortfall was the cost of health care, not the pension. “The pension component is well funded--over 100 percent,” he said. “It is the health care component that has caused a drag on the systems” (Dillon 2005).

The Senate Finance Committee’s bill did not address the funding gap in the retirement system, while the House State Affairs Committee proposal called for addressing the funding shortfall in 2005. With limited time left in the legislative session, some lawmakers indicated a preference to get another opinion and “work over the summer and fall to see if there is a better answer than a total overhaul” (Persily 2005a, p. B1). Commenting on the failure of the Senate measure to address funding, House Minority Leader Ethan Berkowitz called the process “an act of political bullying and arrogance” (Inkelbarger 2005).

The pension debate also became ensnarled with other issues. The Senate reportedly was refusing to approve almost a third of the proposed school state aid as a “tactic to gain school districts' support for rewriting retirement benefits.” The House voted unanimously to reject the

Senate's attempt to link school funding to rewriting retirement benefits (Persily 2005a, p. B1). And Governor Murkowski threatened to veto hundreds of millions of dollars in public works projects across the state “unless the Legislature eliminates pensions for new public employees” (Cockerham and Persily 2005, p. A1).

As the regular session neared conclusion, Democrats in the House proposed a compromise plan to create an *optional* DC contribution plan for new hires (Volz 2005). The Governor vowed to veto any bill that did not include the Senate’s proposal to place *all* new employees into a DC plan. In the final days of the legislative session, the Senate and the House became locked in a stalemate. The clock ran out and a special session was called (Cockerham and Persily 2005). Eventually, the Governor and Republican-controlled legislature secured passage of the DB to DC switch for new hires (Inklebarger 2005).

In an opinion piece published in the *Anchorage Daily News*, former Alaska attorney general John Havelock commented about legislation considered during the special session, including pension reform. He wondered why none of the legislative issues was discussed during the 2005 election campaign, nor included in the Governor’s State of the State address, nor part of Murkowski’s list of priorities. Havelock concluded that the special session “illustrates a democratic process out of kilter” (Havelock 2005, p. B4). He said that “none of the bills was adopted as a result of widespread urging by voters,” nor were voters urging candidates to reduce retirement benefits for new state employees (Havelock 2005, p. B4).

Despite enactment of the legislation, the final chapter on Alaska is yet to be written. Because the plan was adopted rapidly and in a single session, important technical questions remain open. More specifically, the law creating the individual account system may not be in compliance with Federal Internal Revenue Service regulations, which would mean new

employee plans could lose their tax-deferred status. Additionally, the 2008 legislature is holding hearings on Senate Bill 183, which seeks to reverse the retirement plan legislation passed in 2005 (Burke 2008). The legislature moved toward a return to the DB plan when a Senate committee approved in March 2008 “a bill to reopen a DB plan to new teachers and government employees, and jettison a fledgling DC plan some say is harming the state’s ability to attract and keep employees” (Kvasager 2008). Regarding passage of the measure state Senator Kim Elton said, “We took a significant step backwards when we moved to a 401(k). It’s coming home that we have a real problem with defined contribution. It’s probably best synthesized in recruitment and retention. We’re finding it far more difficult to recruit when almost every other public jurisdiction is offering a defined benefit plan” (Kvasager 2008).

California. In his State of the State address on January 5, 2005, California Governor Arnold Schwarzenegger called for an overhaul of the state pension system. The Republican Governor told the Democrat-controlled legislature that the pension system was “out of control” and “threatening our state.” He called for reform that would move new employees from a DB to a DC system that would be “fair to employees and to taxpayers” (Associated Press 2005a), a proposal would affect both the California Public Employees Retirement System (CalPERS) and the California State Teachers' Retirement System (CalSTRS).

Later that month, *The New York Times* reported that the impetus for Mr. Schwarzenegger's plan was generated by the “same anti-tax advocates, free-market enthusiasts and Wall Street interests pushing President Bush's Social Security initiative.” The proposal was “supported by a number of Republican state lawmakers and is driven by the same ideology behind the effort to transform Social Security” (Broder 2005, p. 16). The *Times* predicted that outcome in California “will not only have an impact on the state pension system, but will also

provide an important marker of public opinion on proposed changes to Social Security” (Broder 2005, p. 16).

The initiative was endorsed by Americans for Tax Reform (Broder 2005, ATR 2005). Also supporting the Governor’s proposal was Republican Assemblyman Keith Richman, who drafted legislation and filed the proposal as a ballot initiative. The Governor’s staff indicated that he would campaign for the Richman ballot measure if the legislature failed to act (Wasserman 2005a). Also involved in the policy formulation was Stephen Moore, the former director of the conservative Club for Growth and who also was president of the Free Enterprise Fund, an organization dedicated to remaking Social Security. Moore said that the proposal "aims toward giving people real ownership and a real stake in how the economy and the stock market perform" (Broder 2005, p. 16). Moore also reportedly saw the importance of California in impacting the national agenda, commenting that should the state move from a DB to a 401(k)-type DC system, “the nation is likely to follow” (Broder 2005, p. 16). Several years later, Moore called for an effort to “abolish these anachronistic guaranteed defined benefit pension systems and convert public employees to portable and cost-constrained 401(k)-type pensions” (Moore 2008).

At the time of the proposal, CalPERS was the largest pension system in the country with some \$180 billion in assets for about 1.4 million workers and retirees. CalSTRS was the third largest system with about \$125 billion in assets for some 750,000 members (Wasserman 2005a). Although the Governor described the plans as “a looming train wreck,” *The New York Times* reported that “even advocates of privatization in his own administration say the system is currently sound” (Broder 2005, p. 16). Together, the plans are “nearly 90 percent funded, a level that most experts consider quite healthy” (Broder 2005, p. 16).

Opponents of the plan – which included almost all Democrats in the legislature, state employee unions, and plan trustees – said that the plans had been well-managed and provided critical retirement income for public workers. DB supporters also indicated that the state contribution to the system in 2005 was higher because of a downturn in the market. The state historically had benefited from a strong stock market and “in some years has had to make no payments into the funds” (Broder 2005, p. 16).

The backdrop for the debate was quite complex. The Howard Jarvis Taxpayers Association was involved, proposing a ballot through the initiative process. Additionally, State Treasurer Phil Angelides – a Democrat and board member of both CalPERS and CalSTRS – formed a national coalition of state treasurers and pension fund officials to fight the governor's idea. He called the measure “a major assault on the movement to reform corporate America following a wave of scandals.” Angelides said that the Governor’s plan “is part of a concerted effort to break apart the powerful voices of public pension funds that have stood up for ordinary investors in corporate boardrooms” (Wasserman 2005b). Interestingly, a loyalist of President Bush broke ranks and asked the Governor for an alternative to the DC switch. Gerald Parsky, chair of the University of California Board of Regents and chair of President Bush’s 2000 and 2004 state election campaigns, said the measure would undercut recruiting and the economy. Parsky said, “California's economic competitiveness will suffer if we cannot retain the nation's best and brightest faculty” and in today’s global economy, “California's intellectual capital is our state's chief competitive advantage” (LaMar 2005).

By April 2005, Governor Schwarzenegger abandoned his plan to convert the system primarily because public employees successfully leveraged the fact that the DC plan would not provide suitable death and disability coverage to workers, virtually killing the issue (Wasserman

2005c). In 2006, the Governor established a Public Employee Post-Employment Benefits Commission to propose ways to address growing pension and retiree health care obligations. The Commission was chaired by Republican DB supporter Gerald Parsky. The Commission issued a report in July 2007 that found that the total statewide pension system was 89 percent funded, and that since 2004, CalPERS and CalSTRS experienced annual returns in the double digits which are significantly higher than their assumed rates of return (Post-Employment Benefits Commission 2007; LaMar 2005).

Colorado. In 2006, the Colorado Public Employee Retirement Association (PERA) found itself facing proposals to convert its DB pension system to a DC system. The *Rocky Mountain News* called the 2006 legislative session “the most challenging in PERA's 75-year history” (Milstead 2006b, p. 6B). At the time, the governorship was held by Republican Bill Owen, who supported drastic changes to the pension system and a switch to DC plans (Paulson 2006a). The legislature was controlled by Democrats.

As a matter of background, the retirement system was established in 1931 by the state legislature. PERA initially provided retirement benefits to state employees only, and then was called the State Employees' Retirement Association (SERA). By the end of its first 10 years, SERA had some 4,000 members, 112 retirees, and about \$1 million in assets. For the first 20 years, investments were limited to United States government bonds, or state, school or municipal bonds. The rates of return averaged 2.75 percent (PERA 2008). Today, PERA is a substitute for Social Security for most public employees, and provides retirement and other benefits to nearly 280,000 active and retired employees of more than 400 government agencies and public entities in the state. The system has expanded its range of investments with assets in domestic and

international stocks, corporate, government, and international bonds, real estate, and alternative investments (PERA 2008).

The editorial page of the *Denver Post* reported that while PERA was more than 100 percent funded in 2000, the stock market decline that same year left PERA funded at about 73 percent in 2006. This funding level, opined the paper, does not “add up to a crisis” (Ewgen 2006a, p. E1). According to PERA, the funded status at the end of 2006 was 74 percent with a 15.7% return on investment and \$38.8 billion assets. PERA’s actuary indicated that this funding level is sufficient to pay benefits through the projected actuarial period of 30 years (PERA 2008).

In 2006, there were three major PERA legislative proposals. The first was proposed by House Republican Minority Leader Joe Stengel, which called for placing new public employees in a DC plan. The chief supporter of Stengel’s bill was Fix PERA, an offshoot of the Americans for Prosperity Foundation. PERA’s executive director testified that the measure was a “gross overreaction.” A House Committee voted to postpone the bill indefinitely, which essentially defeated the measure (Milstead 2006a, p. 5B).

The failure of the Stengel bill left two major bills. Senate Bill 174 was sponsored by Democratic Senator Paula Sandoval and reflected PERA’s proposal to maintain the DB system while taking steps to return the system to solid footing by restoring and accelerating the percentage contributed by employees to a previously higher level. Senate Bill 162 was led by Republican Senator David Owen and supported by Governor Owens. This legislation would have left current employees in the DB system and placed future employees in a DC plan (Paulson 2006b). With control of the state government split between a Republican governor and a Democratically-controlled legislature, a compromise solution was reached days before the legislative session concluded. The measure approved by the General Assembly maintained the

DB pension system for all employees while restoring the funding level. The *Denver Post* reported that under the compromise legislation “every new dollar the plan puts in PERA will come from employees, not taxpayers, mostly because employees agreed to contribute an additional 0.5 percent of their salaries into the fund for each of the next six years” (Ewegen 2006b, p. E1). This increase parallels a similar increase in employer contributions previously enacted in 2004. The proposal modified the structure of the PERA Board and also allowed newly-hired employees in higher education to choose either a DC or the DB plan (this provision later was modified to apply only to new employees of the community college system). Democratic Senator Sandoval sponsored the final compromise, which also raised the minimum retirement age for new employees from 50 to 55 (Ewegen 2006b).

Also of note was the fact that FixPERA launched a related ballot initiative campaign. MSNBC reported that the “libertarian leaning” proposal would have declared an “actuarial emergency” and replaced the pension with a DC plan. Americans for Prosperity Foundation “reluctantly withdrew the ballot measure” once compromise legislation was enacted and said in a press release that taxpayers are looking at “an eventually bankrupt system” (Wolk 2006; Americans for Prosperity 2006).

Utah. In 2007, the Utah state legislature began consideration of a measure to convert the Utah Retirement Systems’ (URS) DB plan to a DC system. Such a proposal would have affected 170,000 public employees and retirees, their families, and future workers (URS 2007). It was reported to be one of the “thorniest issues of the 2007 Legislature” (Fahys 2007a). At the time, the data available showed the funding level to be at 96.5 percent (URS 2007). The measure was sponsored by Republican Representative John Dougall. He said that his bill would offer a choice “to employees eager for incentives in a highly competitive job area” (Fahys 2007b). At a

committee hearing on the bill, Dougall called the initiative “an idea whose time has come” and an option that employees insist upon having. The lawmaker called it an employee benefit “that when denied, would drive them to private-sector jobs where they can test their investment mettle” (Fahys 2007a).

In Utah, DB plans began for public employees in 1919 with the creation of the Fireman’s Pension Fund. Until 1963, there were different plans for different classes of employees. That year, all public employee plans were consolidated under URS. The system began offering DC plans to employees in 1971, which were a precursor to what now are 457 plans that allow public employees to supplement their retirement security with individual savings accounts. In 1981, URS also began offering 401(k) plans for Utah public employees in 1981 (URS 2007).

While the 2000-2002 bear market hurt the funding level of many public pension plans, the impacts were not quite so dramatic for URS. Its funded status did decline, but the system was more than 90 percent funded despite one of the most dramatic market fluctuations in history. This can be attributed to the fact that URS did not increase benefits and continued to make actuarially-required contributions during the 1990s bull market (URS 2007).

Utah’s public employees’ pension fund has grown to more than \$17 billion, or nearly double the size of the state’s annual budget, and it serves 163,000 people including schoolteachers, judges, police officers, county clerks, lawmakers, and ex-governors. According to the *Salt Lake Tribune*, it is considered “an asset, the glossy polish on the state’s sparkling financial rating” and “rock solid, fully able to meet its obligations to retirees” (Fahys 2007a).

Nonetheless, the *Salt Lake Tribune* reported that a DB switch measure was triggered by “a conservative Legislature” that was eager to “join a nationwide trend in business and

government." "I feel quite comfortable with the choice option," said Republican State Representative Merlynn Newbold (Fahys 2007a).

On February 24, 2007, the *Salt Lake Tribune* reported that new employees of the state Department of Information Technology (IT) Services would choose between a traditional state pension and a 401k-style DC retirement plan under a bill passed by the Republican-controlled House. The bill passed was a "stripped-down version" of the original Dougall legislation intended to move all new hires to the DC system (Fahys 2007b). Dougall fended off several efforts to kill the legislation, including one that would have created a year-long study. The original measure eventually was defeated, as was Dougall's proposal to allow new transportation and IT hires to choose which system to join (Fahys 2007b).

A cost estimate for implementing the measure suggested that state agencies might have to come up with as much as \$18.4 million to deal with the drain on the retirement fund (Fahys 2007b). An article reporting on the failed measure drew attention to the fact that Republicans have tended to be more supportive of personal retirement accounts than Democrats, noting that the GOP controls the Utah legislature. The article reported that critics of the bill argued that switching state employees from a DB to a DC plan "would create the unintended actuarial consequence of starving the DB plan of contributions" (Defined Contributions & Savings Plan Alert 2007).

To summarize recent activities in the states, interest groups have had a significant impact on the debate over state and local retirement plans in recent years. Because of the long-term nature of retirement plans, the ultimate effects of some of these efforts will not be fully felt for decades. It appears that interest groups' pursuit of their ideological goals are a major reason why proposals to dismantle DBs have risen to the forefront in some states, as evidenced in their broad

statements and actions in states such Alaska, California, and Colorado. It also appears that in recent years, these interest groups saw an opportunity to gain traction on the issue in light of rising contribution requirements to public plans that were the result of the 2000 to 2002 bear market. Interestingly, there did not appear to be active interest group involvement in the Utah debate where the funding and contribution levels did not spike during the bear market. Although interest groups managed to create an audience for their positions with politicians who were ideologically aligned, their rather mixed record in passing legislation to effect a switch from DB to DC suggests that these interest groups may be talking past the public voters and unaligned legislators of either party.

Conclusions

This chapter has explored how public perceptions, political dynamics, and interest groups are shaping the U.S. public pension debate and policymaking. Public pensions have been a successful, shared enterprise between public employees and taxpayers. They have successfully met employees' needs for a secure source of retirement income that is adequate to maintain a middle-class standard of living. At the same time, they have collectively met the test of fiscal responsibility expected by the tax-paying public.

Challenges to public sector DBs do not appear to stem mainly from economic considerations, nor public dissatisfaction. Rather, the public has a low knowledge base and is undecided on the issue. But, where individuals do have a viewpoint, it is often driven by ideological or political beliefs. There does not appear to be a groundswell of discontent on the issue of public pension and no demand rising up from ordinary citizens for wholesale changes. Instead, efforts to dismantle public pensions have been tied to partisan politics and organized

ideological interest groups. Specifically, while prior research suggests that Republican party control is a strong predictor of whether a state makes the switch from a DB to a DC plan, we find that individual Republican voters are no more likely than Democrat or Independent voters to support such a switch, after controlling for other factors, including an ideological predisposition to individualism.

These findings may help to explain the patterns we observe in the states examined. That is, the switch from DB to DC has not been a response to demands from the electorate, nor a response to economic factors. Rather, partisan politics and ideologically motivated interest groups have been a primary driver behind efforts to dismantle public sector defined benefit pension plans.

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Figure 1. Effect of Various Factors on the Probability of Introducing a Defined Contribution Plan.

Source: Adapted from Munnell et al. (2008a)

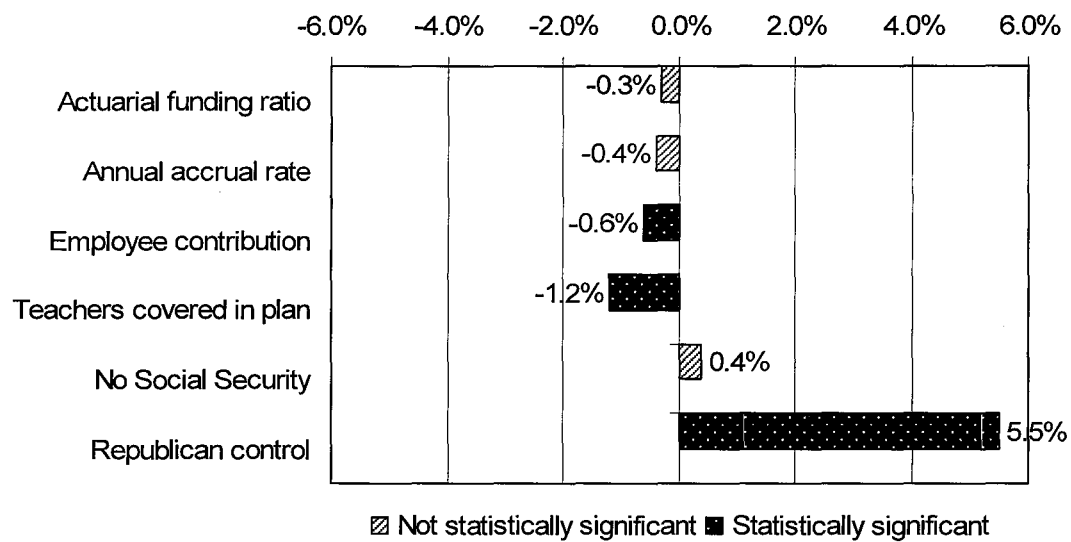


Table 1 Empirical Determinants of the Public's Self-Reported Preferences for Plan Type and Plan Features

	Model Specification 1 Dependent Variable: Support for Switching to 401(k) for public employees	Model Specification 2 Dependent Variable: Preference for a 401(k)-type savings plan	Model Specification 3 Dependent Variable: Preference for receiving benefits based on account balance.
	Coefficient	Coefficient	Coefficient
(Constant)	2.538 (0.243)	0.106 (0.540)	0.020 (0.152)
Age	0.015 (0.020)	0.032 (0.048)	0.004 (0.023)
Female	-0.259*** (0.106)	0.033 (0.245)	-0.026 (0.052)
Education	-0.057 (0.039)	-0.042 (0.088)	0.015 (0.026)
Income	-0.024 (0.030)	0.039 (0.069)	0.061*** (0.019)
Union Member	0.057 (0.150)	-0.136 (0.324)	-0.141** (0.072)
Public Employee	-0.396*** (0.125)	-0.501** (0.275)	-0.124** (0.068)
Have 401(k)	0.077 (0.124)	-0.048 (0.296)	0.131* (0.095)
Have DB Pension	-0.018 (0.154)	-0.926*** (0.347)	-0.327*** (0.103)
Individualistic Ideology	0.201*** (0.059)	0.226** (0.134)	0.079* (0.053)
Republican Party Support	-0.024 (0.036)	0.096 (0.084)	0.033 (0.030)
	n=387	n= 341	n = 287

Notes: Reference category is not having a 401(k) or DB. Significance listed based on one-tailed tests.

*** significant at greater than .01

**significant at greater than .05

* significant at greater than .1

Sources: Author's analysis of 2005 and 2006 Hart Research survey.

Endnotes

¹ VanDerhei (2006) notes that a commonly-used rule of thumb dictates that retirees should seek to replace 75-90 percent of their pre-retirement income to maintain their living standards in retirement.

² Although most state and local employees have DB plans, it is important to note that 14 percent of state and local employees must rely on a DC plan alone (Munnell, Haverstick and Soto 2007).

³ DC plan sponsors could come close to approximating these economies by offering annuity distribution options. In practice, however, most DC plans do not offer annuities (Perun 2007).

⁴ Based on cross-tabulations of the data from the Hart (2005) and Heldrich (2006) polls.



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A Better Bang for the Buck

The Economic Efficiencies of Defined Benefit Pension Plans

by Beth Almeida and William B. Forna, FSA

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Worries about retirement security abound. Families fear that they won't have enough to support an adequate retirement income as home values and financial markets plummet. Dwindling profit margins have employers looking to cut costs. And governments are concerned about delivering on the promises that they have made to their citizens and to their employees as tax revenues shrink amid a weakening economy.

In this environment, some have proposed replacing traditional defined benefit (DB) pensions with 401(k)-type defined contribution (DC) retirement savings plans in an effort to save money. But decision makers would be wise to look before they leap. To deliver the same level of retirement benefits, a DB plan can do the job at almost half the cost of a DC plan. Hence, DB plans should remain an integral part of retirement income security in an increasingly uncertain world because they offer employers and employees a better bang for the buck.

The value of traditional DB pensions to employees is generally recognized: they provide a secure, predictable retirement income that cannot be outlived. But less well known is the value of a DB pension to an employer. Due to their group nature, DB plans possess "built-in" savings, which make them highly efficient retirement income vehicles, capable of delivering retirement benefits at a low cost to the employer and employee. These savings derive from three principal sources.

First, DB plans better manage longevity risk, or the chance of running out of money in retirement. By pooling the longevity risks of large numbers of individuals, DB plans avoid the "over-saving" dilemma – that is, saving more than people need on average to avoid running out of cash – that is inherent in DC plans. Consequently, DB plans are able to do more with less.

Second, because DB plans, unlike the individuals in them, do not age, they are able to take advantage of the enhanced investment returns that come from a balanced portfolio throughout an individual's lifetime.

Third, DB plans, which are professionally managed, achieve greater investment returns as compared with DC plans that are made up of individual accounts. A retirement system that achieves higher investment returns can deliver any given level of benefit at a lower cost.

Because of these three factors, we find that a DB pension plan can offer the same retirement benefit at close to half the cost of a DC retirement savings plan. **Specifically, our analysis indicates that the cost to deliver the same level of retirement income to a group of employees is 46% lower in a DB plan than it is in a DC plan.** This is an important factor for policy makers to consider, especially with respect to public sector workforces, where tax dollars are an important source of funds for retirement benefits. DB plans are a more efficient use of taxpayer funds when offering retirement benefits to state and local government employees.

More specifically, this study finds that ...

- Longevity risk pooling in a DB plan saves 15%,
- Maintenance of a balanced portfolio diversification in a DB plan saves 5%, and
- A DB plan's superior investment returns save 26%

... as compared with a typical DC plan.

TWO APPROACHES TO RETIREMENT: DB AND DC PLANS

Employers who offer retirement benefits can consider two basic approaches: a traditional defined benefit (DB) pension plan and a defined contribution (DC) retirement savings plan.¹ Each type of plan has certain distinguishing characteristics that influence their cost to employers and employees.²

How DB plans work

While employers have a good degree of flexibility in designing the features of a DB plan, there are some features all DB plans share.

DB plans are designed to provide employees with a predictable monthly benefit in retirement. The amount of the monthly pension is typically a function of the number of years an employee devotes to the job and the worker's pay – usually at the end of their career.³ For example, the plan might provide a benefit in the amount of 1.5% of final average pay for each year worked. Thus, a worker whose final average salary was \$50,000, and who had devoted 30 years to the job, would earn a monthly benefit of \$1,875 (\$22,500 per year), a sum that would “replace” 45% of his final average salary after he stops working. This plan design is attractive to employees because of the security it provides. Employees know in advance of making the decision to retire that they will have a steady, predictable income that will enable them to maintain a stable portion of their pre-retirement standard of living.

Benefits in DB plans are pre-funded. That is, employers (and, in the public sector, employees) make contributions to a common pension trust fund over the course of a worker's career. These funds are invested by professional asset managers whose activities are overseen by trustees and other fiduciaries. The earnings that build up in the fund, along with the dollars initially contributed, pay for the lifetime benefits a worker receives when he retires.


How DC plans work

DC plans function very differently than DB plans.

First, there is no implicit or explicit guarantee of retirement income in a DC plan. Rather, employers (and usually employees) contribute to the plan over the course of a worker's career. Whether the funds in the account will ultimately be sufficient to meet retirement income needs will depend on a number of factors, such as the level of employer and employee contributions to the plan, the investment returns earned on assets, whether loans are taken or funds are withdrawn prior to retirement, and the individual's lifespan.

DC plans are typically “participant directed,” meaning that each individual employee can decide how much to save, how to invest the funds in the account, how to modify these investments over time, and at retirement, how to withdraw the funds.

While DC plan assets are also held in a pension trust, that trust is comprised of a large number of individual accounts. DC plans are typically “participant directed,” meaning that each individual employee can decide how much to save, how to invest the funds in the account, how to modify these investments over time, and at retirement, how to withdraw the funds. Retirement experts typically advise individuals in DC plans to change their investment patterns over their lifecycle.




In other words, at younger ages, because retirement is a long way off, workers should allocate more funds to stocks, which have higher expected returns, but also higher risks. As one gets closer to retirement, experts suggest moving money away from stocks and into safer, but lower returning assets like bonds. This is to guard against a large drop in retirement savings on the eve of retirement, or in one's retirement years.

This high degree of participant direction makes DC plans very flexible in accommodating individuals' desires, decisions, and control. Employees, however, do not always follow the best expert advice when it comes to saving and investing for retirement.⁴ Too many workers fail to contribute sufficient amounts to the plans, and individuals' lack of expertise in making investment decisions can subject individual accounts to extremely unbalanced portfolios with too little or too much invested in one particular asset, such as stocks, bonds, or cash.

For example, one study found that more than half of all DC plan participants had either no funds invested in stocks—which exposes them to very low investment returns—or had almost all their assets allocated to stocks, making for a much more volatile portfolio.⁵


Another important difference between DC and DB plans becomes apparent at retirement. Unlike in DB plans, where workers are entitled to receive regular, monthly pension payments, in DC plans it is typically left to the retiree to decide how to spend one's retirement savings. Research suggests that many individuals struggle with this task, either drawing down funds too quickly and running out of money, or holding on to funds too tightly and enjoying a lower standard of living as a result.⁶ In theory, employers that offer DC plans could provide annuity payout options, but in practice they rarely do.⁷

BOTH DB AND DC PLANS ARE IMPORTANT TO RETIREMENT SECURITY



Because individuals do not have perfect knowledge as to whether they will remain in a given job (and therefore in a given DB plan) until retirement, taking advantage of the opportunity to save in a supplemental DC plan can provide employees with useful diversification of retirement income sources.

DC plans are also flexible vehicles that can accommodate individual retirement income needs that can vary. For example, two otherwise identical workers might have different family situations, health needs, or simply different preferences and expectations about their retirement income needs. DC plans give workers the opportunity to save for retirement in a manner that reflects their individual situations.



This is why most retirement experts liken the ideal design of retirement income sources to a “three-legged stool,” consisting of Social Security, a DB plan, and a supplemental DC savings plan. Indeed, researchers have found that workers who have access to all three sources of retirement income are in the best position to achieve a secure retirement.⁸

However, to the extent that retirement benefits for private sector employees constitute a cost to employers, and since benefits for public employees are supported by taxpayer contributions, designing retirement benefits in a fiscally responsible fashion is an important public policy goal. To that end, it is important for policymakers to recognize that the features that make DB plans highly attractive to employees – a predictable monthly retirement benefit, low fees and professional management of retirement assets – also provide significant savings for employers and taxpayers.

DB PLANS ARE MORE COST EFFECTIVE

The cost of either a DB or DC plan depends primarily, but not only, on the generosity of the benefits that it provides. Economists have found that DB plans are typically more generous than DC plans, and obviously, more generous benefits are more expensive.⁹

However, for any given level of benefit, a DB plan will cost less than a DC plan.¹⁰ This makes DB plans, in the language of economists, *more efficient* since they stretch taxpayer, employer or employee dollars further in achieving any given level of retirement income.

This makes DB plans, in the language of economists, more efficient since they stretch taxpayer, employer or employee dollars further in achieving any given level of retirement income.

There are three primary reasons behind DB plans' cost advantage.

- First, because DB plans pool the longevity risks of large numbers of individuals, they avoid the “over-saving” dilemma inherent in DC plans. DB plans need only accumulate enough funds to provide benefits for the average life expectancy of the group. In contrast, individuals will need to set aside enough funds to last for the “maximum” life expectancy if they want to avoid the risk of running out of money in retirement. Since the maximum life expectancy can be substantially greater than the average life expectancy, a DC plan will have to set aside a lot more money than a DB plan to achieve the same level of monthly retirement income.
- Second, because DB plans do not age, unlike the individuals in them, they are able to take advantage of the enhanced investment returns that come from a balanced portfolio over long periods of time. For instance, ongoing DB plans generally include individuals with a range of ages. As older workers retire, younger workers enter the plan. As a result, the average age of the group in a mature DB plan does not change much. This means DB plans can ride out bear markets and take advantage of the buying opportunities that they present without having to worry about converting all of their money into cash for benefits in the near future. By contrast, individuals in DC plans must gradually shift to a more conservative asset allocation as they age, in order to protect against financial market shocks later in life. This process can sacrifice investment returns because people may have to sell assets when they are worth too little due to market fluctuations coinciding with retirement timing. Moreover, they are not able to take advantage of higher expected returns associated with a balanced portfolio.
- Third, DB plans achieve greater investment returns as compared with DC plans based on individual accounts. Superior returns can be attributed partly to lower fees that stem from economies of scale. Also, because of professional management of assets, DB plans achieve superior investment performance as compared to the average individual investor.

METHODOLOGY

We compare the relative costs of DB and DC plans by constructing a model that first calculates the cost of achieving a target retirement benefit in a typical DB plan. We express this cost as a level percent of payroll over a career. We then calculate the cost of providing the same retirement benefit under a DC plan. Additional details on our methodology can be found in the Technical Appendix to this report.

Our model is based on a group of 1,000 newly-hired employees. For the purposes of simplicity, we give all individuals a common set of features. All newly hired employees are female teachers aged 30 on the starting date of their employment. They work for three years and then take a two-year break from their careers to have and raise children. They return to work at age 35 and continue working until age 62. Thus, the length of the career is 30 years. By their final year of work, their salary has reached \$50,000, having grown by about 4% percent each year.

Next, we define a target retirement benefit that, combined with Social Security benefits, will allow our 1,000 teachers to achieve generally accepted standards of retirement income adequacy. The plan provides a benefit in retirement equal to

\$26,684 per year or \$2,224 per month. A cost of living adjustment is provided to ensure the benefit maintains its purchasing power during retirement. Thus, each teacher will receive a benefit equal to 53% of her final year's salary that adjusts with inflation, which we estimate at 2.8% per year. With this benefit and Social Security benefits, each teacher can expect to receive roughly 83% of her pre-retirement income – a level of retirement income that can be considered adequate, but not extravagant.

We define certain parameters for life expectancy and investment returns. Then, on the basis of all these inputs, we calculate the contribution that will be required to fund our target retirement benefit through the DB plan over the course of a career. We do the same for the DC plan.

WHAT IS AN “ADEQUATE” RETIREMENT BENEFIT?

Experts generally believe that in order for a retiree to maintain the same standard of living enjoyed during working years, income from all sources (Social Security, DB pensions, DC savings plans, etc.) should replace roughly 70 to 90 percent of pre-retirement income. Because some expenses (commuting costs, payroll taxes, etc.) disappear after retirement, it may be possible to maintain one's pre-retirement standard of living, even with a replacement ratio (that is, the ratio of retirement income to pre-retirement income) of less than 100%.

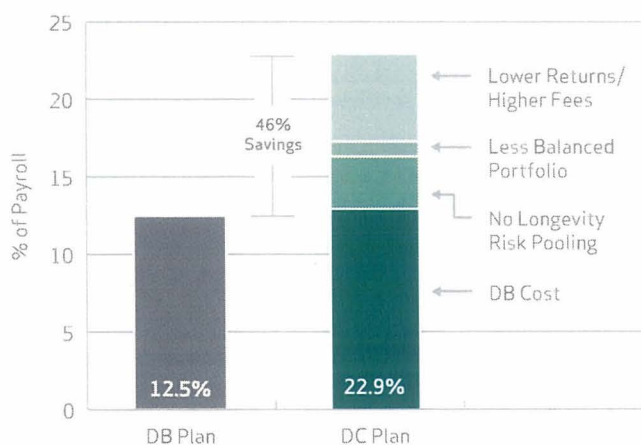
For example, Aon Consulting and Georgia State University estimate that a single retiree with a pre-retirement income of \$50,000 would need to achieve a replacement ratio of 80% in order to maintain pre-retirement living standards.¹¹ Other analysts have recommended that workers seek to achieve an even higher replacement ratio. Human resources consulting firm Hewitt Associates predicts that employees will actually need *more* money in retirement than during their working years, and suggests a target replacement ratio of 125% to cover retiree healthcare and other expenses.¹² In our discussion, we target a replacement rate of 83% of pre-retirement income for both the DB and the DC plan.

DB PLANS ARE MORE COST EFFECTIVE BECAUSE OF LONGEVITY RISK POOLING, PORTFOLIO DIVERSIFICATION, AND SUPERIOR RETURNS

We find that the cost to fund the target retirement benefit under the DB plan comes to 12.5% of payroll each year. By comparison, we find that the cost to provide the same target retirement benefit under the DC plan is 22.9% of payroll each year. In other words, the DB plan can provide the same benefit at a cost that is 46% lower than the DC plan, as shown in Figure 1.

The DB cost advantage stems from differences in how benefits are paid out in each type of plan, how investment allocations shift in DC plans as individuals age, and how actual investment returns in DC plans compare with those in DB plans.

Figure 1:
Cost of DB and DC Plan as % of Payroll

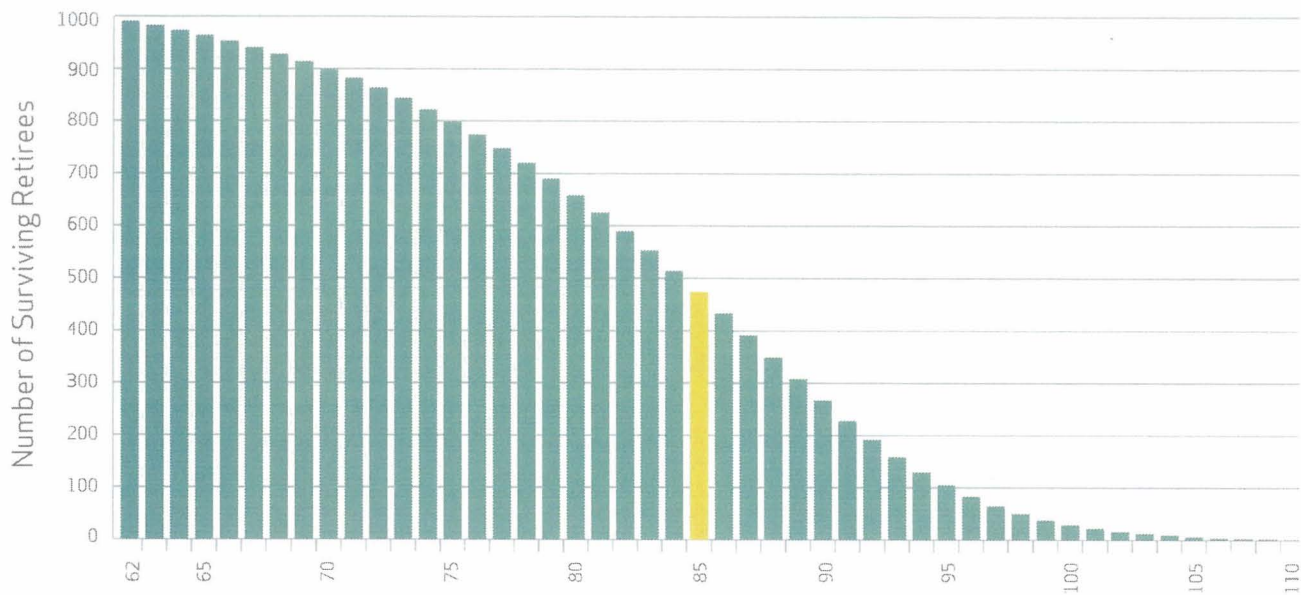


Longevity Risk Pooling

Longevity risk describes the uncertainty an individual faces with respect to their exact lifespan. While actuaries can tell us that, on average, our pool of female teachers who retire at age 62 will live to be 85, they can also predict that some will live only a short time, and some will live to be over 100. Figure 2 illustrates the longevity patterns among our 1,000 teachers. With each passing year, fewer retirees are still living. Age 85 corresponds to the year when roughly half of retirees are still alive.

In a DB plan, the normal form of benefit is a lifetime annuity, that is, a series of monthly payments that lasts until death. A DB plan with a large number of participants can plan for the fact that some individuals will live longer lives and others will live shorter lives. Thus, a DB plan needs only to ensure that it has enough assets set aside to pay for the *average* life expectancy of all individuals in the plan, or in this case, to age 85. Based on our target benefit level, the DB plan needs to have accumulated approximately \$355,000 for each participant in the plan by the time they turn 62. This amount will ensure that every individual in the plan will receive a regular, inflation-adjusted monthly pension payment that lasts as long as they do. The contribution required to fund this benefit, smoothed over a career, comes to 12.5% of payroll.

Figure 2: Longevity of 1,000 Retired Female Teachers



WHAT ABOUT MONEY FOR A SURVIVING SPOUSE?

Our analysis did not explicitly analyze the effect of providing income to a retiree's surviving spouse. But the method of providing for spouse benefits would be similar under either the DB or DC approach. Under a DB plan, a retiree has the option of electing a reduced monthly benefit in exchange for a portion of the benefit continuing on to her surviving spouse if there is one. Virtually all pension plans offer at least a "50% Joint and Survivor" option and a "100% Joint and Survivor" option. For example, in our model, the retired teacher could have three payment options:

- \$2,224 per month for as long as she lives, with no surviving spouse benefit, or
- \$2,046 per month for as long as she lives, with half (\$1,043) continuing to her surviving husband for as long as he lives, or
- \$1,882 per month for as long as either the retiree or her husband lives

These three options are roughly "actuarially equivalent," meaning that for a large group following the actuarially assumed mortality and investment return patterns, the plan costs are neutral with respect to the option chosen.

Under a DC plan, if this retiree wanted to provide her husband with retirement income should he outlive her, she would reduce the amount of her monthly withdrawals to enable him to be more likely to have residual assets available for him upon her death. If the retired couple were to make calculations as to how much to reduce their benefit, they would make calculations identical to those made by the plan to determine the actuarially equivalent benefit.

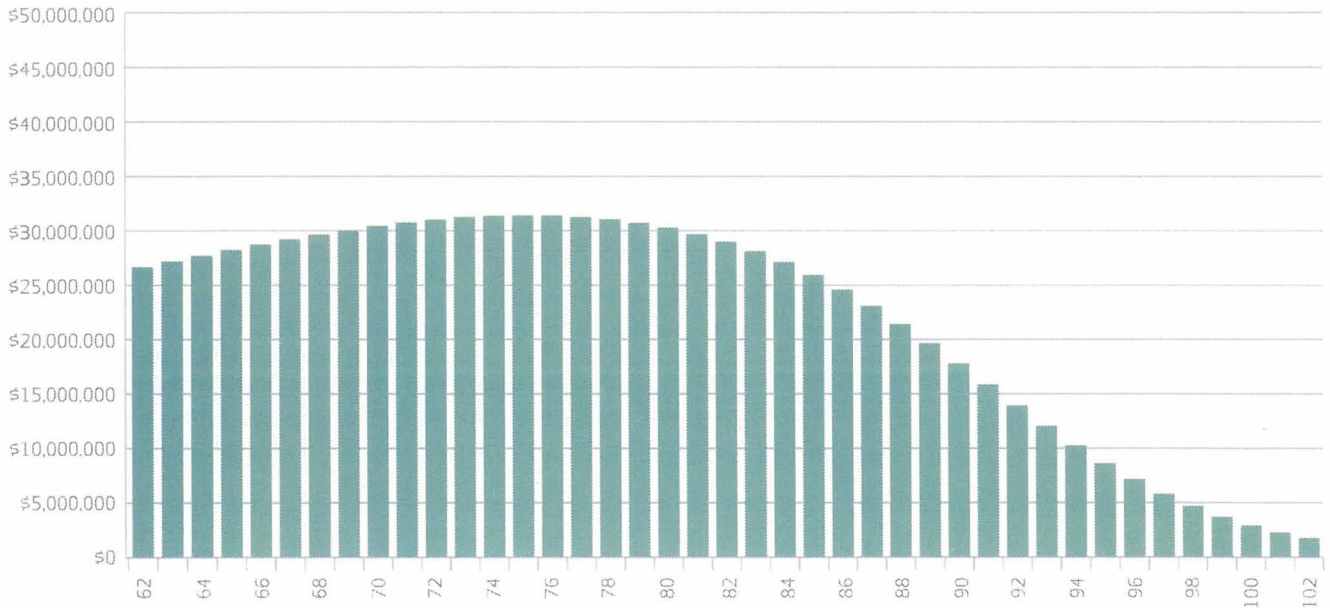
In other words, the desire of providing survivor income can be met through either a DB or DC plan.

We could have modeled our analysis based on a married retiree seeking survivor income protection, but adding this complexity would not have made a material difference in our analysis. This is because while it is difficult for a retiree to predict how long she will live, it is also difficult for a couple to predict how long they each will live.

Total annual payments out of the DB plan will have a hump-shaped pattern as seen in Figure 3. The amount of benefits paid out will increase for a number of years, because the effect of inflation adjustments is greater than the effect of individuals gradually dying off. At age 77, the impact of retiree deaths

overtakes the effect of the cost of living adjustments and payments decline with each passing year. In the DB plan, every retiree receives a steady inflation-adjusted monthly income that lasts until her death.

Figure 3: Total Payments under the Defined Benefit Plan



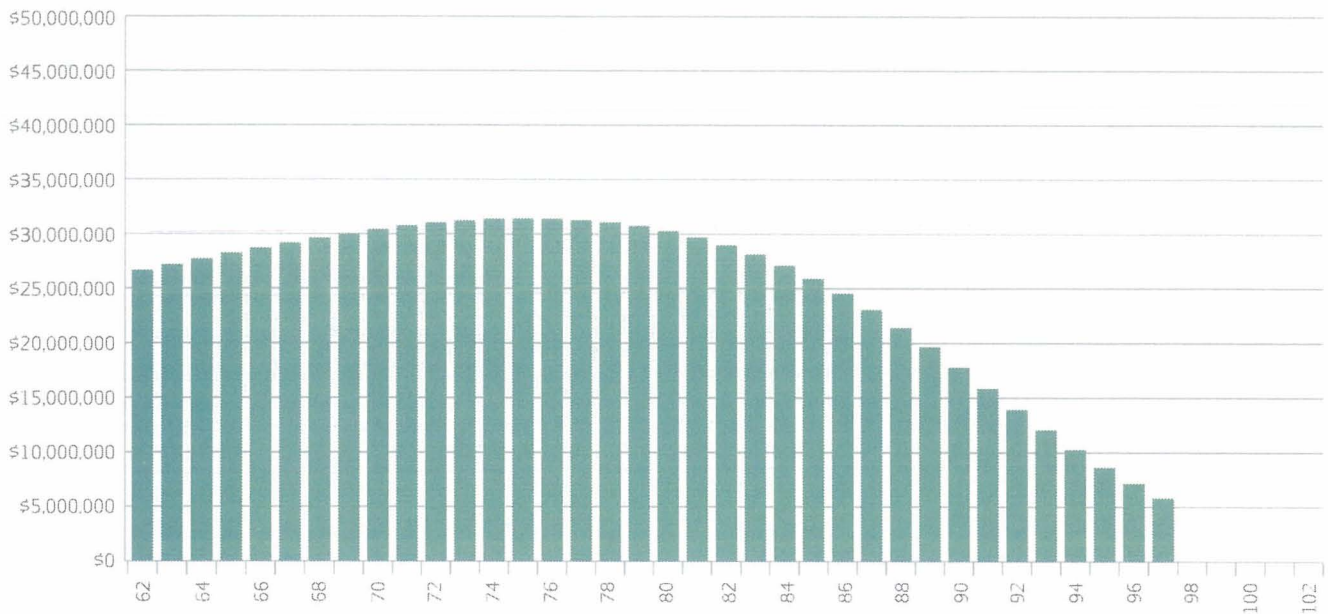
Next, we contrast this situation with that in a DC plan. Because DC plans rarely offer annuity options, individuals must self-insure longevity risks. This can be an expensive proposition. Because an individual in a DC plan does not know exactly how long she will live, she will probably not be satisfied with socking away an amount sufficient to last for the *average* life span, for if she lives past age 85, she will have depleted her retirement savings. For this reason, an individual will probably want to be sure that she has enough money saved to last for the *maximum* life span (or something close to it).

We define the “maximum life expectancy” for purposes of this analysis as 97 years old. It corresponds to the age beyond which only 10% of individuals survive, and therefore it is not a “true” measure of maximum life expectancy.¹³ In fact, our mortality table indicates that one lucky individual out of the 1,000 will celebrate her 110th birthday. This simplifying assumption is intended to be more realistic (that most individuals will be

satisfied with a 90% chance of not outliving their money, rather than a 100% chance), but it will also tend to understate the cost of the DC plan. Figure 4 illustrates the payout pattern under the DC plan, where individuals withdraw funds on an equivalent basis to the DB plan until age 97 – that is, in a series of regular, inflation adjusted payments. After age 97, there are no more withdrawals, even though 100 (10% of our initial pool of 1,000) teachers are still living. The money has simply run out.

Thus, our simplifying assumption of using a 90th percentile life expectancy of 97, rather than the true maximum life expectancy, will reduce the cost of providing the target benefit under the DC plan, but will also mean that individuals with exceptionally long lives will experience a reduced standard of living, compared to what they would experience under a DB plan. Thus, in our example, the DC plan ends up actually delivering less in total retirement benefits than the DB plan.

Figure 4: Total Benefit Payments under the DC Plan Based on Life Expectancy of 97



Of course, those 10% of individuals who do survive beyond age 97 would want to avoid the possibility of having their retirement income reduced to zero. It is likely that individuals will respond to a long life by gradually reducing their withdrawals from the plan to avoid running out of money. Thus, we assume that once an individual reaches age 90, she begins to reduce the size of annual withdrawals from the plan. This changes the withdrawal pattern to avoid the steep drop off in payments at age 97, as shown in Figure 5. However, it should be noted that those with very long lives will see their standard of living reduced significantly.

It is important to acknowledge that if a retiree dies before exhausting all of her retirement savings, the money in the account does not simply evaporate. Rather, it will pass to her estate. Benefits that were intended to be pension benefits become death benefits paid to heirs instead. This is the “over-saving” dilemma that is inherent in DC plans. As Figure 6 illustrates, the aggregate amount of money transferred to estates is substantial – totaling 24% of all assets accumulated in the plan.

While some individual heirs will benefit from these inter-generational transfers of wealth, they are not economically

efficient from a taxpayer or employer perspective. Because heirs did not provide services that the employer/taxpayer benefited from, providing additional benefits to heirs is economically inefficient. Moreover, these additional “death benefits” are not tied in any direct way to an individual employee’s productivity during her working years, rather their value is a function of living a shorter life.

DB plans avoid this problem entirely. By pooling longevity risks, DB plans can not only ensure that all participants in the plan will have enough money to last a lifetime, they can accomplish this goal with less money than would be required in a DC plan. Because DB plans need to fund only the *average* life expectancy of the group, rather than the *maximum* life expectancy for all individuals in the plan, less money needs to be accumulated in the pension fund. Remember that the DB plan needed to accumulate about \$355,000 for each participant in the plan by the time they turn 62 in order to fund the target level of benefit. Due to the “over-saving” dilemma, DC plans must accumulate at least \$455,000 per participant, or \$100,000 more, in order to minimize the likelihood of running out of funds. In order to accumulate those additional amounts, contributions to the plan would climb to 16.0% of pay, from 12.5% under the DB plan.

Figure 5: Total Benefit Payments under the DC Plan Based on Adjusted Life Expectancy

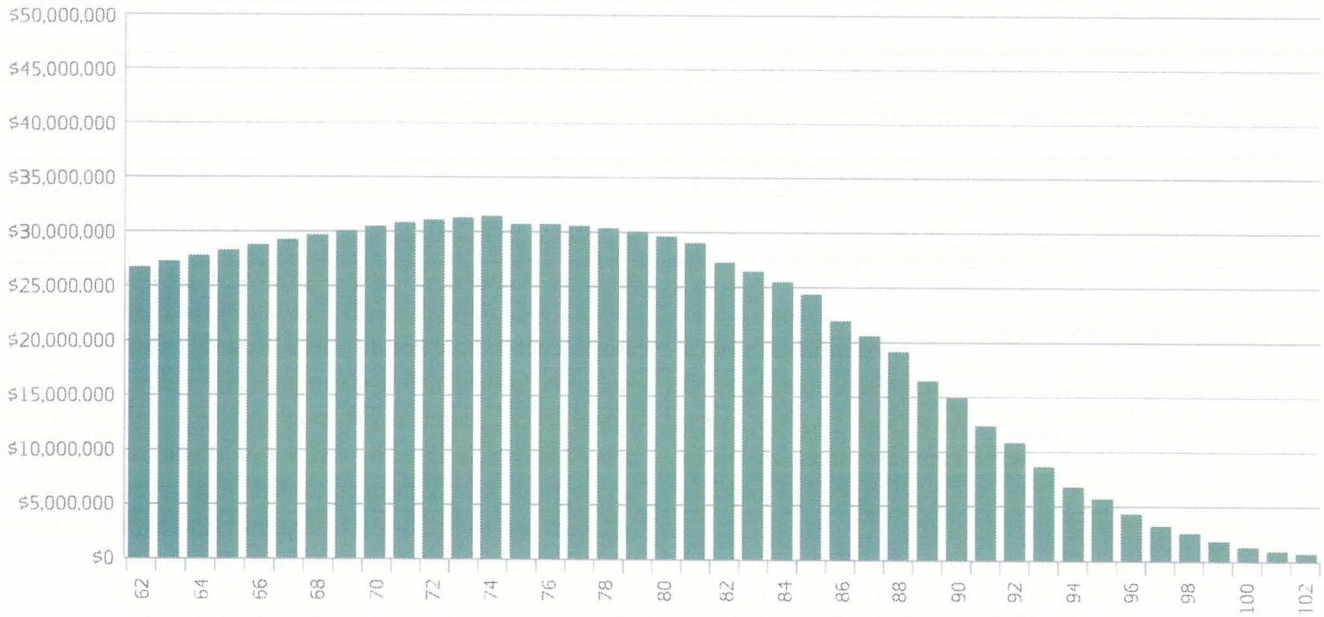


Figure 6: Total Benefit + Estate Payments under the DC Plan



We find that the shift in portfolio allocation has a modest, but nonetheless, significant effect on cost. Specifically, we find that the per-retiree amount that must be accumulated in the DC plan by retirement age now climbs to about \$485,000. By comparison, the DB plan requires about \$355,000. The contributions required to fund the target benefit level now climb to 17.0% of payroll (compared to 12.5% of payroll under the DB plan).

Another important reason why DB plans achieve higher investment returns than DC plans is that assets are pooled and professionally managed.

Superior Returns

Another important reason why DB plans achieve higher investment returns than DC plans is that assets are pooled and professionally managed. Expenses paid out of plan assets to cover the costs of administration and asset management reduce the amount of money available to provide benefits. As a result, a plan that can reduce these costs will require fewer contributions. By pooling assets, large DB plans are able to drive down asset management and other fees. For example, researchers at Boston College find that asset management fees average just 25 basis points for public sector DB plans.¹⁵ By comparison, asset management fees for private sector 401(k) plans range from 60 to 170 basis points.¹⁶ Thus, private DC plans suffer from a 35 to 145 basis point cost disadvantage, as compared with public DB plans.¹⁷ On their face, these differentials may appear small, but over a long period of time, they compound to have a significant impact. To illustrate, over 40 years, a 100 basis point difference in fees compounds to a 24% reduction in the value of assets available to pay for retirement benefits.¹⁸

Administrative costs are largely driven by scale. Thus, a similarly-sized DB plan and DC plan can have opportunities to negotiate minimized administrative expenses. A DC plan involves costs that do not exist in a DB plan, such as the costs of individual recordkeeping, individual transactions, and investment education to help employees make good decisions.

However, DB plans, unlike DC plans, bear the administrative costs of making regular monthly payments after retirement.

But fees are only part of the story – differences in the way retirement assets are managed in DB and DC plans play a substantial role. As previously discussed, investment decisions in DB plans are made by professional investment managers, whose activities are overseen by trustees and other fiduciaries. Research has found that DB plans have broadly diversified portfolios and managers who follow a long-term investment strategy.¹⁹ We also know that individuals in DC plans, despite their best efforts, often fall short when it comes to making good investment decisions. Thus, it should not be surprising that researchers find a large and persistent gap when comparing investment returns in DB and DC plans. Munnell and Sunden put the difference in annual return at 80 basis points.²⁰ A 2007 report from the global benchmarking firm, CEM, Inc., concluded that between 1998 and 2005, DB plans showed annual returns 180 basis points higher than DC plans, largely due to differences in asset mix.²¹ And Watson Wyatt found that, between 1995 and 2006, DB plans outperformed DC plans by 109 basis points, on average. Among large plans, the DB advantage was even greater – at 121 basis points.²²

In our model, we use conservative estimates of the differences in DB and DC plan costs and expected returns. We model a 100 basis point (1%) net disadvantage for the DC plan annual investment returns as compared with DB plan returns. While this is slightly higher than the estimate of Munnell and Sunden,²³ it is lower than the more recent estimates of Flynn and Lum,²⁴ and Watson Wyatt.²⁵ This 100 basis point differential persists into the retirement years and magnifies the effects of the shift in asset allocation discussed previously. However, our model separates these effects to avoid double-counting. We do not isolate the impact of expenses and fees from the impact of superior investment management skill.

We find that a 1% per year disadvantage in DC plan investment returns compounds over time to create a significant cost disadvantage. In particular, we find that the amount which must be set aside for each individual at retirement age now climbs to about \$550,000 (compared to the roughly \$355,000 required in the DB plan). The level of contributions to the plan climbs again, this time to 22.9% of payroll (compared to 12.5% under the DB plan).

“BUT I THOUGHT DC PLANS WERE CHEAPER?” UNTANGLING BENEFIT GENEROSITY AND ECONOMIC EFFICIENCY

GM Will Freeze Salaried Pensions, Shift to 401(k)s

“...move will save the struggling automaker \$420 million in 2007.”
USA Today - April 10, 2007

IBM Adds Its Name to the List of Firms Freezing Pensions

“...cut worldwide retirement-related expenses by \$450 million to \$500 million this year.”
The Washington Post - January 6, 2006

Verizon to Halt Pension Outlay for Managers

“...company hopes to save about \$3 billion over the next decade.”
The New York Times - December 6, 2005

Headlines like these have, understandably but unfortunately, led to a good deal of confusion about the relative costs and economic efficiencies of DB plans versus DC plans. While many employers have cited the financial burden of DB plans as their main reason for shifting from a DB to a DC plan, it is important to separate the question of benefit generosity from the question of the economic efficiency of a retirement plan.²⁶

A review of the economic literature helps in this regard. Researchers have found that when employers move out of DB and into DC plans, they almost always cut the average employee benefit in the process.²⁷ Ghilarducci and Sun find, for instance, that between 1981 and 1998 the average employer pension contribution declined from \$2,140 to \$1,404 per employee, while the share of pension contributions attributed to DC plans increased from 23% to 68% in that time period.²⁸ Also, a UK study found that the average contribution per employee is 15-18% under a DB system, but only 9% under a DC system.²⁹ Thus, when employers simultaneously reduce their contributions along with the move from DB to DC, they will undoubtedly save money. Yet this does not mean that DC plans are inherently cheaper than DB plans; it simply means that employers are reducing employee benefits, while also changing the benefit design. Shifting costs from one party (the employer who reduces contributions) to another (employees who receive less in retirement) does not reduce costs overall. As the *The Economist* succinctly put it, “Whatever the arguments about the merits of the new wave of [DC] schemes, if you put less money in, you will get less money out.”³⁰

Whether an employer chooses a DB plan, a DC plan, or both, it has to decide how generous the benefits should be. But, as our analysis demonstrates, the economic efficiencies built into DB plans mean that such systems can provide the same benefit at a much lower cost, as compared with a DC plan.

SUMMARY OF RESULTS: DB PLANS REDUCE COSTS BY ALMOST HALF

Taken together, the economies that stem from investment pooling and longevity risk pooling can result in significant cost savings to employees and employers (or in the case of the public sector, taxpayers). In our model, required contributions are 46% lower in the DB plan as compared with the DC plan.

Our analysis clearly demonstrates that DB plans are far more cost-effective than DC plans. We find that to achieve roughly the same target retirement benefit that will replace 53% of final salary, the DB plan will require contributions equal to 12.5% of payroll, whereas the DC plan will require contributions to be almost twice as high – 22.9% of payroll.

We find that due to the effects of longevity risk pooling, maintenance of portfolio diversification, and greater investment returns over the lifecycle, a DB plan can provide the same level of retirement benefits at almost half the cost of a DC plan.

Figure 8: Tallying DB Plan Cost Savings

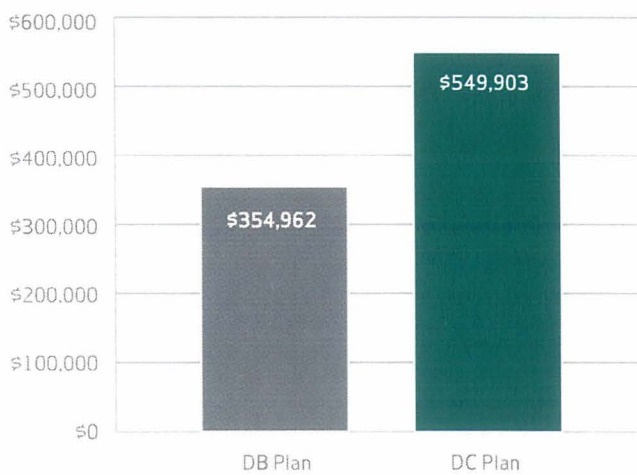
1. Longevity risk pooling saves	15%
2. Maintenance of portfolio diversification saves	5%
3. Superior investment returns save	26%
All-in costs savings in DB plan	46%

The longevity risk pooling that occurs in the DB plan accounts for 15% of the incremental cost savings. DB plans' ability to maintain a more diversified portfolio drives another 5% cost savings, and their superior investments returns across the lifecycle generate an additional 26% reduction cost.

Our results also indicate that DB plans can do more with less. That is, they can ensure that all individuals in the plan (even

those with very long lives) are able to enjoy an adequate retirement benefit that lasts a lifetime, at the same time that they require less money to be contributed to a retirement plan and fewer assets to accumulate in the plan. We calculated the amount of money that would be required to be set aside for each retiree in each type of plan, to provide a modest retirement benefit of about \$2,200 per month. As shown in Figure 9, at retirement age, the DB plan requires only about \$355,000 to be set aside for each individual, whereas the DC plan requires almost \$550,000. The difference – nearly \$195,000 for each and every employee – illustrates that the efficiencies embedded in DB plans can yield large dollar savings for employers, employees and taxpayers.³¹

Figure 9:
Per Employee Amount Required at Age 62
DB Plan vs. DC Plan



CONCLUSION

Our findings indicate that DB plans provide a better bang for the buck when it comes to providing retirement income. We find that a DB plan can provide the same level of retirement income at almost half the cost of a DC plan. Hence, DB plans should remain a centerpiece of retirement income policy and practice, especially in light of current fiscal and economic constraints.

We find that the biggest drivers of the cost advantages in DB plans are longevity pooling and enhanced investment returns that derive from reduced expenses and professional management of assets. The sacrifice of investment returns that results from life-cycle driven shifts in portfolio allocation in DC plans had a smaller, but still significant, effect. The sources of cost savings in DB plans reflect, at a very basic level, the differences in how DB and DC plans operate. Group-based DB plans provide lifetime benefits and feature pooled, cost-efficient, professionally managed assets: these features drive significant cost savings that benefit employers, employees, and taxpayers.

When considering our results, it is important to keep in mind that in our effort to construct an “apples to apples” comparison, we made a number of simplifying assumptions that actually reflected more favorably on DC plans. For instance, we did not model any asset leakage from the DC plan before retirement, through loans or early withdrawals nor any terminations of employment under either plan. We also assumed that individuals followed a sensible “goldilocks-like” withdrawal pattern in retirement – not too fast, not too slow, but just right. We used conservative estimates of the difference in actual investment returns between DB and DC plans. And, we used a 90th percentile life expectancy to project required accumulations in the DC plan, rather than “full” life expectancies. Thus, if anything, our analysis likely underestimates the cost of providing benefits in a DC plan and thereby understates the cost advantages of DB plans.

Due to the built-in economic efficiencies of DB plans, employers and policy makers should continue to carefully evaluate claims that “DC plans will save money.” As discussed, benefit generosity is a separate question from the economic

efficiency of a retirement plan. While either type of plan can offer more or less generous benefits, DB plans have a clear cost advantage for any given level of retirement benefit. Considering the magnitude of the DB cost advantage, the consequences of a decision to switch to a DC plan could be dramatic for employees, employers, and taxpayers.

While either type of plan can offer more or less generous benefits, DB plans have a clear cost advantage for any given level of retirement benefit. Considering the magnitude of the DB cost advantage, the consequences of a decision to switch to a DC plan could be dramatic for employees, employers, and taxpayers.

Finally, policymakers should consider proposals that can strengthen existing DB plans and promote the adoption of new ones. When viewed against the backdrop of workers’ increasing insecurities about their retirement prospects and the economic and fiscal challenges facing employers and taxpayers, now more than ever, policy makers ought to focus their attention and energy on this important goal. The very features that make DB plans attractive to employees drive cost savings for employers and taxpayers. In this way, DB plans represent a rare “win-win” approach to achieving economic security in retirement that should be recognized and replicated.

TECHNICAL APPENDIX: CALCULATING THE COST SAVINGS EMBEDDED IN DB PLANS

We calculate the cost, expressed as a level percent of payroll over a career, of achieving a target benefit in a typical DB plan and compare that with the cost of providing the same target benefit in a typical DC plan.

We begin by constructing a cohort of 1,000 newly-hired employees. For the purposes of simplicity, we give this cohort a common set of features. All newly hired employees are age 30 on the starting date of their employment and they are all female teachers. They work for three years and then take a two-year break from their careers to have and raise children. They return to work at age 35 and continue working until age 62. Thus, the length of the career is 30 years. By their final year of work, their salary has reached \$50,000, having grown by 4.05% percent each year.

Modeling DB Plan Benefits and Costs

The DB plan provides a benefit in retirement equal to 1.85% of final average salary for each year worked. This represents the median benefit among DB plans covering public employees who are also covered by Social Security.³² Final average salary is calculated on the basis of the final three years of one's career, which in this case is \$48,079. Thus, the initial benefit in the DB plan is \$26,684 per year or \$2,224 per month.

The DB plan provides a cost of living adjustment that ensures the benefit maintains its purchasing power during retirement. Inflation is projected at 2.8% per year. Thus, each individual in our cohort will receive a benefit equal to 53% of her final year's salary that adjusts with inflation. This DB plan (in combination with Social Security) would allow an employee to meet generally accepted standards of retirement income adequacy, or roughly 83% of pre-retirement income.

DB plans typically offer married participants the ability to receive joint-and-survivor annuity benefits, whereby when the retiree dies, her spouse can continue to receive a monthly benefit that will last the spouse's lifetime. But the retiree pays the cost of this survivor's benefit. That is, the monthly benefit that would be payable on a single-life basis will be reduced by an actuarially determined factor to account for the fact that payments may continue if the retiree dies before her spouse. Therefore, for simplicity, we model all benefit payouts on a single-life basis (and do the same for the DC plan), using the RP-2000 Healthy Female Annuitants mortality table.

In order to model the contributions that are required to fund these benefits, we start by establishing expected investment returns. The DB plan is expected to achieve nominal investment returns of 8.01% per year, net of fees. We calculate a weighted average return, based on assumptions about asset allocation and returns for each asset class.

The DB plan follows a typical asset allocation of 2% in cash/liquid assets, 15% in treasuries/agency debt, 13% in corporate bonds, and 70% in equities and alternative assets. Our expected investment returns for each asset class are based on the projections prepared by the Office of the Actuary of the Social Security Administration to support analysis of the impact of private accounts by the President's Commission to Strengthen Social Security. The Commission's report described these assumptions as "conservative," noting that these assumptions are "much lower than that used in many academic and policy studies."³³ We expect cash/liquid investments to earn a nominal 2.8% per year, treasuries and agency debt to earn 5.8%, corporate bonds to earn 6.3%, and stocks and alternatives to earn 9.3%. Asset management fees of 0.25% are deducted from these returns, reflecting the average for DB plans in the public sector.³⁴

Figure 10	% of Assets	Expected Annual Investment Return
Cash/Liquid Investments	2%	2.8%
Treasuries and Agency Debt	15%	5.8%
Corporate Bonds	13%	6.3%
Stocks and Alternatives	70%	9.3%
Less Asset Management Fees		-0.25%
Overall Portfolio		8.0%

On the basis of these inputs, we calculate the contribution that will be required to fund this benefit through the DB plan over the course of a career, and express this as a level percent of payroll. We find that the cost to fund the target retirement benefit, smoothed over a career, comes to 12.5% of payroll. Contributions could be made entirely by the employer, or, in the public sector, they may be split between the employer and employee.

Modeling DC Plan Benefits and Costs

Modeling the cost of the target retirement benefit in the DC plan requires some adjustments based on what we know about how DC plans differ from DB plans.

First, because employees are not provided with an annuity benefit at retirement under the DC plan, we determine the size of the lump sum amount that an individual would need to accumulate by their retirement date in order to fund a retirement benefit equivalent to that provided by the DB plan (including inflation adjustments) for a period of 35 years, or to age 97. This represents our estimate of the “maximum life expectancy.” It corresponds to the age beyond which only 10% of individuals survive, and therefore is not a “true” measure of maximum life expectancy. In fact, our mortality table indicates that one individual out of 1,000 will survive to 110. This simplifying assumption is intended to be more realistic (that most individuals will be satisfied with a 90% chance of not outliving their money, rather than a 100% chance). Using a 90th percentile life expectancy of 97, rather than the true maximum life expectancy will reduce the cost of providing the target benefit under the DC plan, but will also mean that individuals with exceptionally long lives will experience

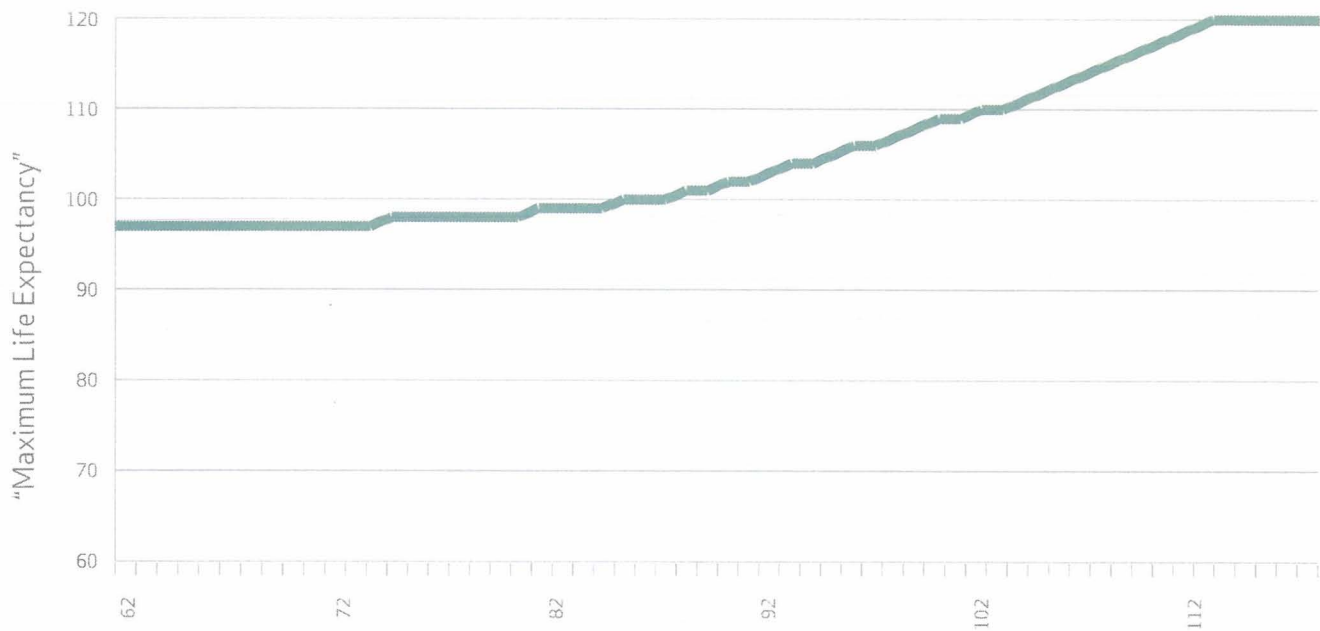
a reduced standard of living, compared to what they would experience under a DB plan.

Of course, those 10% of individuals who do survive beyond age 97 would see their standard of living drop quite dramatically once their DC accounts were depleted. In reality, individuals would be likely to respond to a long life by gradually reducing their withdrawals from the plan to avoid the possibility of having their retirement income reduced to zero. For this reason, we assume that once an individual reaches age 90, she reduces annual withdrawals from the plan. We assume that the individual monitors her “maximum life expectancy” each year, and whenever it increases by a year, she adjusts her withdrawals accordingly. Figure 11 illustrates this process.

To model the impact of the shift to a more conservative portfolio allocation, starting at age 62, we have individuals begin to shift their portfolio allocation to gradually reduce the share held in equities and increase the holdings of cash and liquid investments, treasuries and agency debt, and corporate bonds. At age 62, the portfolio holds 65% of assets in equities; by age 72 it holds 49%; by age 82, it holds 33%; by age 92, it holds 16%; and so on. This drives the expected return on the baseline portfolio down from 8% per year to 6% per year in nominal terms.

The investment/withdrawal strategy we model is not the result of an optimization rule, rather it follows ad hoc rules. The investment strategy is modeled as a “glide path,” along which the retiree gradually reduces her exposure to equities. Withdrawals are designed to mimic DB plan payouts, at least in the early years of retirement, declining in later years. Work by William Sharpe and colleagues suggests that an optimal approach would integrate investment and withdrawal

Figure 11: "Maximum Life Expectancy" increases as one gets older



strategies. Specifically, they find that a constant withdrawal rate must be paired with a riskless investment strategy in order to be optimal for an individual.³⁵ However, a post-retirement asset allocation entirely concentrated in risk-free assets would dramatically drive up the cost of the DC plan. Thus our model's ad hoc investment and withdrawal strategies would tend to understate the cost advantage of DB plans.

We use conservative estimates of the differences in DB and DC plan costs and expected returns. We assume that a large, sophisticated employer will seek to use whatever economies of scale are available to negotiate fees down on both types of plans. To capture the effect of lower DC plan returns over a lifetime, due to fee differentials and superior investment decisions, we model a 100 basis point disadvantage in net return as compared with DB plan returns. While this is slightly higher than the estimates of Munnell and Sunden,³⁶ it is lower than the more recent estimates of Flynn and Lum³⁷ and Watson Wyatt.³⁸ Thus, we assume individuals achieve a 7% nominal rate of return during their working years. This 100 basis point differential persists into the retirement years. So the return disadvantage compounds on top of the shift in portfolio allocation. (We calculate the impact of each effect separately to avoid double counting.) As a result, the expected

return on the portfolio gradually declines from 7% per year to 5% in nominal terms.

On the basis of these inputs, we calculate the contribution that will be required to fund this benefit through the DC plan over the course of a career, and express this as a level percent of payroll. We find that the cost to fund the target retirement benefit, smoothed over a career, comes to 22.9% of payroll in the DC plan.

Future extensions of our model might incorporate additional differences between DB and DC plans. For example, one could analyze the impact of "leakage" of assets from DC plans through loans or early withdrawals, two features which are rare in DB plans. Pre-retirement death and disability benefits, which are a common feature of DB plans, but not DC plans, could be considered as well. Finally, the model could be extended to capture cyclical and idiosyncratic variances in investment returns. That is, one could analyze the effects of ups and downs in financial markets and the impact that these have on investment returns and costs in both DB and DC plans over a career. Also, the fact that in DC plans some individuals will have "better luck" with investing than others means that individuals' retirement prospects will exhibit a wider dispersion than what is predicted by our model.

- 1 The most common type of DC plan in the private sector is the 401(k) plan. Public sector employees often save for retirement in 403(b) plans or through 457 plans. These nomenclatures reflect the sections of the Federal tax code that spells out the rules governing these plans.
- 2 Both types of plans also share some common features. For instance, they both are employment-based plans that make preparing for retirement easier than if employees had to tackle the job completely on their own. Both DB and DC plans benefit from tax incentives designed to encourage retirement preparedness. And both types of plans are governed by laws designed to protect employees and their benefits.
- 3 The benefit factor could also be a function of a worker's earnings over their entire career (a so-called "career average plan.") Or, the factor could be a flat dollar amount: for example, the plan will pay a monthly benefit equal to \$50 per year of service, so that a 30 year employee would have a benefit of \$1,500 per month. "Flat dollar" plans are primarily seen among blue-collar workers in the private sector.
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- 11 Palmer, B., R. DeStefano, M. Schachet, J. Paciero, and C. Bone. 2008. *2008 Replacement Ratio Study*. Chicago, IL: Aon Consulting.
- 12 Hewitt Associates. 2008. *Total Retirement Income at Large Companies: The Real Deal*. Chicago, IL: Hewitt Associates.
- 13 Authors' calculations based on RP-2000 Healthy Female Annuitants mortality rates. Society of Actuaries. "Table 4-6: Female RP-2000 Rates." *RP-2000 Mortality Tables*. at http://www.soa.org/files/pdf/rp00_mortalitytables.pdf.
- 14 Another factor is particularly important in the discussion of investment – the degree to which contributions and investment earnings remain in the plan until retirement. This is generally not an issue in DB plans, but is a concern in most DC plans, where employees can borrow from their retirement account or take money out before retirement age (with the attendant tax penalties). This problem of "leakage" from DC plans has been well-documented and is receiving more attention by researchers and policy-makers. (See Weller, C., and J. Wenger. 2008. "Robbing Tomorrow to Pay for Today: Economically Squeezed Families are Turning to their 401(k)s to Make Ends Meet." CAP Economic Policy Report. Washington, DC: Center for American Progress.)
- 15 One basis point is equal to 0.01%. Thus 25 basis points is equal to one-quarter of one percent, or 0.25%.
- 16 Munnell, A.H. & M. Soto. 2007. "State and Local Pension Plans are Different from Private Plans." Center for Retirement Research State and Local Pensions, No. 1. Boston College.
- 17 This large fee gap may be attributable to several factors. One is plan size. Since most public pension plans tend to be very large compared to many private sector DC plans, their lower fees may be attributable to scale economies. Another factor may be differences in asset mix, which analysts find to be a key driver of asset management fees. However, here the direction of the effect is not entirely predictable. Although DB plans invest in less expensive index funds more often than DC plans, they also are

more likely to invest in assets that involve higher expenses (but also higher returns), such as real estate, private equity, or hedge funds. (Flynn, C. 2008. Author's correspondence.)

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- 28 Ghilarducci, T. and W. Sun, op. cit.
- 29 Blake, D. op. cit.
- 30 *The Economist*, op. cit.
- 31 There is an additional consideration for taxpayers we do not explore. Qualified retirement plans involve a significant amount of foregone revenue to federal and state treasuries, because taxes on contributions and investment earnings are deferred. To illustrate, the exclusion of DB and DC plan contributions and income from Federal tax involved a loss of \$108.6 billion in revenue in 2007. By comparison, the mortgage interest tax deduction cost \$73.7 billion. (See Joint Committee on Taxation. 2007. *Estimates of Federal Tax Expenditures for Fiscal Years 2007-2011*. Washington, DC: US GPO, September 24.) Since our analysis demonstrates that DC plans require more assets to be accumulated to deliver the same amount of retirement benefits, it is likely that the implicit tax subsidy to deliver \$1 in retirement benefits through a DC plan exceeds that provided to deliver \$1 in benefits through a DB plan. Valuing this impact is beyond the scope of this report, however, and analysis this issue must be left for future research.
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- 35 Sharpe, W.F., J.S. Scott, and J.G. Watson. 2007. "Efficient Retirement Financial Strategies." *Pension Research Council Working Paper PRC WP2007-19*. Philadelphia, PA: The Wharton School, University of Pennsylvania.
- 36 Munnell, A.H. and A. Sunden, op. cit.
- 37 Flynn, C. and H. Lum, op. cit.
- 38 Watson Wyatt, op. cit.

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Reinventing the Retirement Paradigm

EDITED BY

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Chapter 1

The Changing Retirement Paradigm

Robert Clark and Olivia S. Mitchell

A century ago, most workers spent 10 hours per day and six days per week on their jobs (Costa 2000). Today, the typical North American spends only five days at work per week and only 7–8 hours per day on the job; some Europeans enjoy an even shorter workweek of a mere 35 hours. This striking time-series decline in work effort has also been reflected in falling labor force attachment patterns, particularly at older ages. In 1880, for instance, 80 percent of men aged 65+ were in the labor force; only a century later, fewer than 20 percent of such older men worked or sought work (Costa 1998). These dramatic reductions in labor and effort are commonly interpreted as indicative of economic and political success. That is, as societies grew richer, and goods and services grew relatively less labor-intensive to produce, more people could afford to spend more of their lifetimes not working. This is perhaps illustrated most vividly in the dimension of leisure at older ages: people everywhere are retiring earlier, and living longer during retirement, than ever before in human history.

Yet many now believe that the race to shorten the work life is over. As the first wave of baby boomers moves into early retirement, it already is clear that some industries such as aerospace, utilities, and health care, face labor shortages. Some argue that life will change dramatically in the next two decades, particularly if employers do not find sufficient workers and if productivity fails to grow fast enough. One analyst, Steven Nyce (K@W 2004a), warns that 'companies will not be able to meet consumption needs in society, and the result will be higher inflation'.

As a result of these labor force changes, employers and employees are having to confront the need for a new retirement paradigm. The old model assumed a relatively homogeneous labor force where employee benefits, particularly pensions, were designed to reward career employees after years of loyalty, effort, and productivity. When labor force growth was the norm, many firms favored hiring plentiful younger workers over retaining more costly older employees. It was in that context that employers developed defined benefit (DB) plans that benefited mainly full-career employees, while penalizing those who remained with the firm only a few years. These traditional pension plans typically included subsidized early retirement provisions that encouraged senior employees to retire in their fifties.

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As a new retirement paradigm emerges, its outlines look quite different from the old model. Several factors are key. For one, the workforce now has higher levels of labor market turnover, higher rates of female participation, and more diverse needs due to employees in increasingly complex family situations. All these changes imply a new set of expectations about the role of work and the nature of employment, including the role of company-provided benefits. Developments are occurring in the pension sector as well. Many companies must now refashion their offers so employees can accumulate retirement saving even while changing jobs, or as they move from full-time work to complete retirement. In addition, important changes in accounting standards, funding requirements, and government regulations are driving plan sponsors to revisit whether they wish to offer retirement benefits, and if so, how these benefit offers will be structured.

A key motivation for rethinking the retirement paradigm is that many people and the societies they live in cannot afford to finance twenty, thirty, or more years of inactivity. Social Security and old-age medical programs face insolvency, and many fear they will not be able to make ends meet in the very near future. A related issue is that older workers are in better health than their predecessors, and their jobs are less physically demanding than in the years gone by. These factors, combined with employees' growing attention of the many risks they face in retirement, are driving a rethinking of the types of benefits promised at the workplace.

The goal of this volume is to provide structure and new insights for the debate on the shape of the new retirement paradigm, and to help key elements of retirement policy reform. In this chapter, we review the key policy challenges, provide evidence on retirement patterns, old and new, and offer elements of the new mix. We conclude with observations drawn from the rich international experience.

Retirement Policy Challenges

Before evaluating some of the innovative practices fashioned by employers and employees confronting these new challenges, it is useful to take stock of the influential role of governmental regulation and oversight regarding the changing retirement environment. This is particularly important in the US context, since employers who offer pensions do so voluntarily. As a result, company-based pension coverage is far less than complete. Indeed, only half the civilian workforce currently has a company pension, a fraction that has remained stable for more than four decades.

Over that time, however, DB plans providing retirees with annuity payments have been supplanted by defined contribution (DC) plans such as 401(k), which offer workers incentives to save but do not require annuitization nor protection from capital market risk. Many DB plans encouraged early retirement, but today that incentive structure is often seen as a vestige

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of a labor surplus era. By contrast, DC plans are increasingly popular due to their portability and age-neutrality (K@W 2004a).

One of the major problems in the policy arena is that trust has eroded between plan sponsors and workers participating in the pension system. This is partly the result of the ongoing fallout from the Enron debacle (along with various other firms suffering earnings shocks in the last five years). The result is that regulators tend to give plan sponsors too little flexibility regarding how plans are designed and operated.

Chapters 2 and 3 discuss the current outlines of pension regulation and examine potential paths for future reforms. In Chapter 2, Klein posits that more regulatory flexibility would be desirable, in exchange for possibly harsher penalties in the event of rule violation. He also suggests the value of negotiated rulemaking. Currently, regulators ask for a wide range of views on regulations and return with a final set of regulations, where there is little room for adaptation. By contrast, a negotiated system would result in a situation where 'the parties would have greater faith in the system knowing they were more involved in the process' (K@W 2004a).

In Chapter 3, Perun and Steuerle point to the fact that the pension system has become inordinately complex over time. Currently, more than 110 private pension plan types are slated to come on line by 2006: a plethora of options that is simply overwhelming for most pension participants and many employers. This suggests that simplification must be high on the agenda in the near future. Two reform proposals are explored in some depth, including a more traditional 'nip and tuck' approach which tinkers with many elements of the law but does not change the fundamental framework, and a second, more fundamental approach proposed by the Bush Administration which includes Lifetime Savings Accounts (LSAs) and Retirement Savings Accounts (RSAs). The latter are simpler and tend to undermine company-based saving versus individual accounts. As Perun says, 'neither proposal is satisfactory'; indeed she states that 'we don't need more innovative savings tools; we just need one that works'. The authors' preferred middle way would boost saving incentives for a simple DC plan and would also reform the social security system to increase benefits for low-wage workers.

Looking ahead, it seems clear that policymakers must do better to clarify how pension assets are protected, prevent plan sponsor malfeasance, and provide strong incentives for the establishment and maintenance of group-based retirement plans. Yet these policies must also be assessed against the need for new retirement behaviors.

Retirement Patterns—Old and New

Important changes in the older worker labor market are evident along several dimensions. First, workers themselves are more diverse, inasmuch

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as they are more mobile, better educated, and healthier than ever before, even as they grow older as a group (Mitchell et al. 2003). Second, transitions in retirement patterns and expectations are beginning to emerge. For instance, in most developed nations there are rising fractions of working women spending ever greater portion of their lifetimes attached to work outside the home. At the same time, there have been dramatic increases in the number of minority workers, workers in nontraditional families, and workers with no families. These facts, combined with slower labor force growth, are altering the age structure and demands of the labor force, making it more difficult for firms to find young workers and increasing the likelihood that employers will want to retain older workers.

Research by Mulvey and Nyce (Chapter 7) reported here points out that by 2010 the US will experience a seven percentage point worker shortfall, which is forecasted to grow to 13 percent by 2020. Furthermore, all baby boomers will be older than 55 by 2020. Nevertheless, many retirement plans have encouraged workers to retire before the age 65. Partly as a consequence, the analysis by Abraham and Houseman (Chapter 5) finds that many companies today have become quite interested in employing older people. 'Employers are concerned about the ability to recruit workers,' says Abraham. Yet the data show that many employees indicate that they would like to work beyond the firm's retirement age, but few in fact do so. Indeed, only one-quarter of older workers surveyed said they planned to stop working entirely at the firm's normal retirement age; of the rest, 18 percent said they planned to work fewer hours, 5 percent said they wanted to change jobs, and the rest said they had no plans. It is of interest that, when they were interviewed two years later, most of those who planned to stop work actually did so, but most of those who planned to work fewer hours had not followed through. Abraham believes that the 'disconnect' may have to do with available jobs: most of the slots are not particularly more attractive than before.

Mulvey and Nyce go on to note that, while the US Employee Retirement Income Security Act (ERISA) of 1974 guaranteed accrued DB plan benefits, that law did not require employers to continue to provide future pension accruals. Insofar as employers offer pensions voluntarily to minimize turnover and receive certain tax benefits, at the same time they have faced soaring administrative costs over time, with costs tripling over the last two decades. As a result, almost two-thirds of companies with fewer than 1,000 workers dropped their DB plans between 1990 and 2002; among larger companies, 11 percent dropped their DB plans (K@W 2004a). Mulvey also notes that more than 20 percent of DB participants are now in hybrid plans, which combine elements of DB and DC plans which cater to a more mobile workforce. While some critique hybrid plans, suggesting that they cut employee benefits, her data indicate hybrid plans add costs to employers and protect older workers. Nevertheless some employers cannot provide any pensions because of regulatory constraints.

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The question of whether employers can and do adjust their human resource policies to provide older employees more flexible work schedules is taken up again in a related study by Robert Hutchens and Kerry Papps (Chapter 8). They see phased retirement as a way to encourage older workers to extend their time in the labor force, permitting workers to transition from full-time to part-time work without changing employers. A clear advantage of such a model is that the worker would be able to curtail work hours while maintaining existing skills and job relationships. It is therefore interesting that some employers require the workers to 'officially' retire before rehiring them for shorter work hours jobs, and sometimes the time interval between official retirement and rehire is only a day.

Drawing on a special establishment survey, Hutchens and Papps find some fascinating results. First, employers favor informal arrangements regarding the rehiring of retired workers or phased employment. Second, employers who do permit some form of phased retirement do not usually restrict it to rehiring of retirees; indeed, most employers indicate they would permit informal hours reductions both before, and after, official retirement. Last, they find little support for the claim that pensions or hours constraints drive firm preferences. Instead, it appears that employers and employees find ways to reduce work hours in flexible ways, and they predict that individually negotiated arrangements will become an evermore important element of the evolving retirement paradigm.

Employers have other ways to change their incentive plans for those nearing retirement that could help extend work lives. For instance, Mulvey and Nyce suggest that employers consider offering elder care programs that assist with the care of older relatives, and phased retirement programs that allow older workers to cut back on their hours without losing benefits. In their survey, one-quarter of the women who retired early were responsible for caring for an older relative, Mulvey notes (K@W 2004b); 'These are the softer side of benefits, but they matter and they're not too costly to implement.' She also finds that men are less responsive to phased retirement programs.

Elements of the New Mix

As a result of these fundamental environmental changes, corporate as well as public sector retirement policies must also evolve. How will this new retirement paradigm be developed? Who bears the responsibility for changing the framework for retirement decisions? Answers to these questions require a new perspective regarding the role of workers, firms, financial services providers, and the government, in the provision of retirement security.

In many countries, it seems clear that pensions must be restructured to facilitate innovative retirement plans while still providing insurance and risk management features for both workers and firms. In this new

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environment, workers and their families will be asked to assume greater responsibility for their own retirement saving. Since retirement wealth accumulation is a lifetime responsibility, workers must be induced to start planning and saving when young, and monitor these retirement plans throughout their working careers. This is a time-intensive process, requiring frequent updating of saving targets and behavior. The retirement plans of twenty-first century workers should also embody some notion of likely changes in government benefits such as Social Security and Medicare, along with changes in company-provided pension plans and retiree health insurance.

The changing patterns of work and retirement are already creating pressures for pension reform. Innovative plan designs along with better fund management are being seen in both the public and private sectors. Ambachtsheer's study (Chapter 11) of DB pension plan investment practices suggests that pension management was guided by a set of rules that appeared to work well during the 1980s and 1990s. During this period, equity risk premiums were generally positive; equity market dips were short and soon reversed themselves, and nothing happened that a 60–40 equity-bond mix policy could not deal with. But the 'perfect pension storm' of 2000–2 developed deep cracks in the old retirement lens. DB plan surpluses turned to serious deficits, and stakeholders began to realize that the asset mixes adopted during the 1990s exposed the stakeholders of DB balance sheets to material mismatch risk. As a result, pension organizations can no longer be guided by the 'old' paradigm, but rather they require a new lens through which to see the world.

In his analysis of the pension plan type question, David McCarthy (Chapter 6) notes that recent developments in numerical analysis help researchers assess different pension plan designs using an economic framework realistic enough to assist researchers and practitioners who study and design pension plans. He develops a framework to design pension schemes to evaluate the best 'pension design'. He uses a financial economics approach to the problem of pension design, recognizing that compensation arrangements can have very distinct impacts on employees covered by these plans. In particular, pension contracts alter workers' risk exposures and the allocation of compensation over the lifecycle. As a result, having a pension changes the value that employees ascribe to different pension and compensation arrangements. His model implies that a DB plan magnifies workers' risk exposure to salary risk, while both DC and DB pension arrangements defer pay to later in the work life. As a result, younger workers therefore value DC plans because they have immediate cash needs. By comparison, DB pensions are a relatively cost-effective way to compensate older, less well-educated employees. He also concludes that underfunding the DB plan is an expensive way to pay employees, as is giving workers with 401(k) plans restricted company stock. Finally,

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McCarthy suggests that a hybrid scheme might be designed to better suit both types of employees. Donald Elbaum, director of pension actuarial studies at Ford Motor Co., suggests that the idea of reducing early retirement subsidies is gaining ground in national pension plans around the world and in private schemes (K@W 2004a).

In their analysis of US public sector pension plans, Anderson and Brainard (Chapter 12) provide useful observations for private plans, based on their assessment of the successes of public sector pensions. They note that public sector plans in the USA cover 14 million state and local government sector participants (10 percent of the US workforce) with assets of over \$2 trillion. These public sector pensions evolved before, and outside the purview of, much federal pension legislation, making their different experiences invaluable for private industry. The authors conclude that the economic boost afforded to public pension benefits will rise as Baby Boomers retire and public retirement systems distribute increasingly larger amounts. Unlike the social security system, which is mainly a pay-as-you-go program, public pension funds are almost entirely funded. The \$2.3 trillion in assets have a significant, positive effect on financial markets and the economy, and the plan structures have enabled public employers to achieve important objectives related to the recruitment and retention of quality workers

As pensions plans change, financial literacy and knowledge increases in importance as workers are asked whether they will participate in a retirement saving or pension plan, as well as how much to contribute and also how to invest the funds. In this new environment, employee knowledge and financial planning become extremely important. Arnone (Chapter 9) takes up the issue of who should bear the responsibility for providing financial education, describing educational programs currently being provided. Arnone, who runs employer-investor education programs, said that companies began offering financial literacy programs in the early 1980s as they encouraged workers to take early retirement. He believes that 'the rationale was that if these older employees did the calculations, they would conclude they were better off (taking early retirement).' He adds: 'I think we're going to have a resurgence, only now they are going to conclude, "I cannot retire as soon as I thought I could"' (K@W 2004a). Arnone states that fewer than 20 percent of large employers initiated financial education programs. Indeed, his own firm once offered financial planning but found that other benefits, including pet insurance, were more popular.

Among investors who manage their own retirement accounts, some of the common problems include questionable asset allocation, failure to rebalance periodically, and an overconcentration in employer stock. Approximately 20 percent of DC participants have outstanding loans and many cash out at time of termination. 'The latest, biggest, hottest thing now is professionally managed 401(k) plans', says Arnone.

10 Robert L. Clark and Olivia S. Mitchell**International Experiences**

The triple challenges of an aging population, a slowly growing labor force, and increasing life expectancy confront many developed nations, and indeed most other developed countries are further along this path than is the USA. Fertility is much lower in Japan and in most of Europe and life expectancy is considerably higher in many of these countries. Many developed countries are already experimenting with reforms to their national Social Security programs and employer-based pensions. It seems likely that policymakers in all developed countries should learn from each other.

Sundén on Sweden (Chapter 14), Usuki on Japan (Chapter 15), and Pozzebon on Canada (Chapter 13) provide interesting insights into how these countries are modifying their retirement programs to address the challenges of the twenty-first century. Turning first to Sweden, Sundén notes that the Swedish Parliament passed pension legislation in 1998 transforming that country's public pension scheme from a pay-as-you-go DB plan to a notional DC. In addition, that reform introduced a second-tier DC individual account plan. This reform fundamentally changed the provision of public pension benefits and redefined the benefit promise. For instance, in the new system, government-provided benefits are closely tied to contributions, and lifetime earnings determine benefits. The reform also recognized that increased life expectancy should influence the system's financial stability, and so it built in an automatic benefit adjustment process that responds to changes in longevity. Finally, the new system also introduced a funded individual-accounts component.

In the process, Swedish policymakers recognized a fundamental and very interesting insight: namely, that pension systems are dynamic institutions which must adjust to constantly evolving demographic and economic circumstances. So as to limit political risk, the reformers proposed automatic adjustments to contribute to system stability. The downside was that the notional DC approach has all adjustments operate through changes in benefits; raising contributions is not an option since it also increases promised benefit. We also note that the Swedish system offers a minimum guaranteed benefit well above the poverty level. For such countries, pension schemes in which adjustment take place both on the benefit and the contribution side might be preferable.

In related work, Usuki points out that Japanese DB plan managers have become extraordinarily disappointed with the ineffectiveness of pension plan asset managers of late, in large part due to the narrowing risk premium in capital markets since 2000. Increasingly, they turn their eyes to the field of liability management and benefit design, seeking to control the financial risks of the pension plans offered. Recent measures taken include DB plan termination, DB benefit cuts, the put-back of the contracted-out portion, and adoption of cash balance or DC plans. As a consequence, we

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conclude that Japanese pension plan sponsors are using financial criteria to drive important pension outcomes. Usuki reports that determinants of DB plan termination include the volatility of return on shareholder equity, the pension plan funding ratio, and the size of pension assets and liabilities relative to the size of the plan sponsor. In addition, plan size also influenced decisions to terminate many Japanese employee pension funds (EPFs.) Turning to the decision to put back the contracted-out portion of the EPF, he again concluded that plan type choice is an important part of corporate risk management when the portfolio includes pension liabilities. Those findings imply that financial risks will remain a main concern for Japanese pension plan sponsors, with higher plan terminations and put-backs of the contracted-out portion of EPFs in the future, as well as additional conversions from traditional DB to cash balance and DC plans.

In the North American context, Pozzebon notes that the Canadian public pension system has long been seen as one of the best in the world. Indeed, to protect against the pressures of an aging population, the public system has become partially funded leading to a feeling of greater confidence among the Canadian population. Nevertheless, while some might believe that Canada's retirement system stands on reasonably solid ground, it still faces many daunting challenges. In particular, the private sector component appears to have weakened substantially during the last decade. The gradual shift from DB to DC, with a parallel move away from retirement saving arrangements covered by pension regulation, portends increasing insecurity for tomorrow's retirees. The author concludes that review of pension governance rules and analysis of the plan sponsor liability environment would strengthen the multi-pillar foundation of Canadian retirement income.

Fore (Chapter 10) illustrates how global accounting standards may influence US pensions substantially. The long phase in pension profitability came to an abrupt end in March 2000, with the bursting of the stock market bubble and the onset of the bear market. As many have noted, the fact that interest fell sharply also made matters worse, boosting the present value of DB pension liabilities. DB plan underfunding grew phenomenally: for standard and poor (S&P) 500 firms, around 70 percent of which offered DB plans, these plans were around \$300 billion overfunded in 1999, but by mid 2003 were underfunded by \$340 billion. Furthermore, many of those firms had an older workforce and many annuitants; most rapidly approach the day when they will begin paying out large pension cash flows on a sustained basis. Such an abrupt shift in DB plan funding status raises the question of whether pension accounting rules are consistent with the principles of pension finance.

The movement to require US pension sponsors to conform to global standards illustrates how international trends can affect retirement policies in other nations. As standard-setters move toward international

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convergence, it now seems clear that this trend will continue. On the whole, this new accounting paradigm appears to the author to be an improvement over the old paradigm, with its emphasis on smoothing and its decoupling of risks from returns. Opponents of fair value standards have argued that switching to these will introduce excessive volatility to financial statements for little or no benefit to users and issuers of statements. These arguments continue, yet the standards are set for adoption in Europe from 2005.

Conclusions

The new retirement paradigm must fit the realities of population aging, rising life expectancies, and the need to finance adequate retirement income. Many questions have been addressed regarding the meaning of retirement in a world with very different expectations. Slower growth in the labor force, combined with new definitions of work and retirement, clearly imply that traditional DB plans will not meet many stakeholders' needs in the labor force of the future. As a result, fewer firms will offer early retirement subsidies to encourage workers to retire in their fifties in the future; instead, company retirement policies must be amended to fit new needs. All of this is taking place against the backdrop of anticipated changes in national social security rules to improve financing, encourage continued work, and delay retirement.

A key problem noted by Rep. Earl Pomeroy (D-N Dakota) is that the US Congress tends to think in two-year bursts, which becomes a problem when it comes to legislating pension reform. 'This mismatch in long-term liabilities and short-term fiscal planning has never been starker in any period in our history,' he points out. 'Our children will pay the price'. Another is that the DB pension funding situation has become rather bleak in the US and around the world. Even with a reasonably good economy, it will take many years before these systems can be restored to solvency. And as the contributors to this volume point out, immediate application of a fair value framework would run the risk of massive DB plan terminations. On the other hand, improved disclosure rules will aid users of financial statements, and they in turn will make their voices heard concerning the quality of information disclosed.

A powerful engine driving the reform of retirement income security systems in the next decade will probably be convergence—the movement to a common approach for reporting plan assets and liabilities. This will surely change the way DB plan investments are managed and the way benefit formulas work, and it will make fixed-income investment strategies more consistent with immunization and duration than in the past. In the USA, where many DB plans have relatively old demographic structures, plan sponsors and investment managers may concentrate more on investment strategies attuned to the timing of retirement benefit cash flows.

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While the old accounting conventions may have encouraged DB plan sponsors to invest too much in equity, some will claim that the new standards will encourage too much fixed income in pension fund portfolios. Ultimately, accounting rules work best when they are neutral with respect to economic decision-making, when they acknowledge that returns are coupled with risks of a long-term nature.

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Chapter 2

Looking Backward, Looking Forward: Where is Pension Policy Headed?

James A. Klein

An inescapable element of the retirement paradigm is the public policy environment within which pension laws and regulations are developed. Issues of plan design, investment choices, and financing are matters that are principally determined by plan sponsors and participants with the help of service providers and other experts. Yet all of these decisions are made against the backdrop of a retirement system that is in large part structured according to rules that were either established or reaffirmed by the key pension law, the Employee Retirement Income Security Act (ERISA) of 1974, and by amendments to that law enacted over the past thirty years.

In the future, the retirement paradigm will be reinvented because people and entities directly engaged in designing and sponsoring plans, as well as those benefiting from plans, will make countless decisions about their immediate and long-term needs. They will adjust retirement plan programs, and retirement practices themselves, to accommodate those needs. Depending on how much thought is put into the development of the new paradigm, the pension institution may be refashioned in a logical and orderly way, or reinvented piece by piece. But, either way, to effectuate many of the changes that will lead to a new retirement paradigm will inevitably require public policy changes. In the best case scenario, the public policy arena will actually facilitate the development of the new paradigm. But if we are not so fortunate, the public policy arena will be the black hole into which thoughtful ideas plunge, never to emerge again. Because the public policy dimensions will be so crucial to the reinvention of a new retirement paradigm, this chapter identifies four elements that may help in the development of a paradigm suitable for the next thirty years. These are the key role of trust in a regulatory scheme; the importance of balancing objectives in pension policy; the key importance of recognizing expectations; and the need for retirement policy champions.

The Key Role of Trust

Government officials and private sector representatives from many countries have sought to learn about the US pension system as they wrestle with the development of private sector individual and employer-sponsored retirement systems in their own countries. It seems clear that, whatever else they might accept or reject from our system as they develop their own, they should give thoughtful consideration to the concepts enshrined in Title I of ERISA dealing with fiduciary responsibilities. This is because much of the success of the US retirement system relies on the fact that workers and employers are willing to turn over large sums of money to one or more third parties, believing that this money will be responsibly managed and prudently invested, and it will be used to pay retirees benefits many decades into the future.

Commensurate with this trust is the confidence that if, by chance, the people and entities to whom these funds are entrusted should act in a negligent or dishonest fashion, then an enforcement system will hold them to account. Such faith in the system is not based on a naïve confidence in the goodness of others; rather, it is based upon a belief in the essential soundness of the structure set forth in ERISA. That this system is largely self-policing is an even more remarkable tribute to how well it works most of the time. It is not merely a linguistic coincidence that the vehicle into which pension assets are placed is called a 'trust'.

The US pension system is, of course, far from perfect. But the unfortunate instances of neglect or abuse regarding private retirement plans that are identified (and punished) are attributable more to the misfeasance of a few, rather than due to fundamental shortcomings in the legal framework of the entire pension system. What is unclear, of course, is what percentage of those who act in a negligent or abusive manner are identified under the current regulatory and enforcement regime. Thus it is with some trepidation that I call for greater *trust* between the regulators and the regulated community when redesigning the pension regulatory structure.

Pension practitioners have long decried the growing complexity of pension law in the aftermath of ERISA. Perhaps those of us with little or no experience in other policy arenas (e.g. environmental and housing) may overstate the complexity of pension policy relative to other areas of the law. Even so, in a voluntary retirement system, the concerns of those who must be relied upon to establish and maintain plans cannot be lightly dismissed. Whatever the truth might be (and 'complexity' itself is a rather subjective condition), the fact that the rules governing the pension system are often difficult to understand and expensive to implement seems to be a point conceded even by those who believe that the rules are warranted.

In some respects, the complex regulatory scheme in place today is a by-product of the breakdown in trust between the government and the plan

sponsor community. This was perhaps most clearly evidenced in the reformulation of pension nondiscrimination rules in 1986, when a looser 'facts and circumstances' standard was changed to more precise mechanical rules. On one hand, the rejection of the 'facts and circumstances' approach was a response to complaints from plan sponsors themselves, who felt that the interpretation and enforcement of those standards were inconsistent and arbitrary (Gale et al. 1999). Plan sponsors had lost faith in the regulators. On the other hand, the movement toward a more rigid standard was also a manifestation of regulators' unease as to whether plan sponsors were designing their plans in a way that was fair to participants at different income levels.

Yet it would be an oversimplification to attribute much of the highly regulated nature of the pension system to a breakdown in trust between the 'regulators' and the 'regulated'. The late Michael Gordon (1999), one of the fathers of ERISA, summed up the essential paradox of ERISA when he wrote about the law's 'mandatory imposition of substantial regulatory standards on a totally voluntary system'. The fact that many employers who are not required to sponsor a plan continue to do so, despite costly and complex regulatory requirements, is a testament to the underlying strength of the system and the belief of plan sponsors that retirement plans are important, despite the difficulty of maintaining them. Yet, to the extent that the regulatory burden is cited by employers as a reason not to sponsor a plan, the challenge for the future is to forge a system in which the regulatory requirements do not undermine the willingness of plan sponsors to initiate or continue a plan.

Another dimension of the regulatory scheme that governs the pension system involves the substantial notice and reporting requirements that accompany the sponsorship of a private sector retirement plan. To the extent that these responsibilities require plan sponsors to report information to participants, the enduring challenge is to make sure that the information conveyed is relevant and understandable. When reporting requirements are based on the government's need to receive information in order to ensure compliance with the law, the regulated community should accept some burden as the application of the Reagan Doctrine of nuclear disarmament ('trust but verify') to the pension system. The problem is that if the new retirement paradigm is still to be based on the premise of a *voluntary* system, Congress and government agencies responsible for developing complex rules and for requiring the reporting of voluminous information must ensure that the regulatory burden satisfies a cost-benefit analysis at least in some rough sense. Future regulators must demonstrate more clearly than in the past that the information required, and the complex testing to which plans must be subjected is, in fact, necessary to achieve some greater objective.

How might this be accomplished? At the margin, legislative and regulatory relief could be enacted to strip away some of the more obvious forms of

regulatory overkill that have developed as successive Congresses and agencies have developed new rules. Indeed in the last few years, Congressional action has simplified the operations of the pension system. But meaningful progress toward a new regulatory framework based on concepts of fairness and equity will require a different mindset between the regulated community and the regulators, one where the essential ingredient is the restoration of trust between plan sponsors and regulators.

From the regulators' perspective, this greater trust may need to take the form of looser rules that afford plan sponsors more flexibility in the operation of plans, with fewer precise hurdles that must be cleared. From the plan sponsors' perspective, this trust might be manifested in a willingness to accept even harsher penalties for failure to meet more flexible standards that would be established. In other words, the regulated community could be accorded more trust that they are designing and operating plans for the benefit of participants and beneficiaries within a broader framework of the enunciated public policy. In return, regulators would be accorded more trust that they will enforce the law consistently and fairly within that more flexible framework; and they would also be empowered to impose even greater sanctions, in instances when the actions taken are clearly inconsistent with the retirement security objectives of the underlying rule (e.g. abuse cases).

This trade-off would represent a fairly substantial gamble on the part of both the regulated community and the regulators, yet there is reason for optimism. In recent years, both the Internal Revenue Service (IRS) and the US Department of Labor have initiated programs in which pension plan sponsors are accorded more protections from sanctions for various violations if they come forward voluntarily to disclose the violation.¹

One confidence-building measure to spur a more desirable regulatory structure would be to engage parties with a legitimate stake in the outcome of regulations more fully *with one another* during the development of regulations. Since ERISA's enactment, most retirement policy rulemaking has involved the agencies' inviting the input of parties with an interest in the rules to provide written comments, to testify at public hearings and to meet directly with regulators to discuss concerns. The level of communication between the regulators and interested parties is excellent, yet the many segments of the retirement system with disparate interests rarely engage in simultaneous discussions with one another and the regulators.²

The Importance of Balancing Objectives

The tax and labor aspects of pension policy have not always been in balance over the past three decades. As a result, there is currently no consistent legislative and regulatory regime, nor is there a coherent retirement

income policy. On the one hand, regulatory agencies with enforcement responsibilities over the pension system have well-defined roles and have avoided directly conflicting activities since the adoption of Reorganization Plan No. 4 in 1978 [543 *Fed. Reg.* 47713, Oct. 17, 1978]. On the other hand, it is probably fair to say that the Congressional committees with oversight of pension law have been less consistent than the regulatory agencies about staying within the purview of their own jurisdiction.

For instance, the numerous parallel provisions of pension law enshrined in ERISA and in the Internal Revenue Code (IRC), resulted, in part, from the lack of trust between Congressional tax and labor committee members when the pension law was crafted in 1974. Each committee wanted to protect its turf and ensure ongoing oversight authority. This dual regulatory structure may be a necessary outgrowth of the fact that pension policy is and must be an amalgam of labor and tax policy. That said, were there more collaboration between and among the Congressional committees of jurisdiction and—to a lesser extent—the executive branch agencies with jurisdiction over the nation's retirement system, the oversight of the pension system today would be a great deal simpler and more consistent.

Some observers have suggested that the dual jurisdiction of the US Department of Labor and the US Department of Treasury/Internal Revenue Service could be merged into a single federal department with retirement system oversight. In support of this idea, critics emphasize conflict between the US Treasury Department's mission of raising tax revenue, and the retirement system's goal of promoting saving (Siciliano 2004). The idea of a unified federal agency certainly bears thoughtful consideration, but it is possible to achieve greater retirement system cohesion without going that far.

The principal impetus for ERISA was the need to protect pension rights, so fiduciary concerns were a strong motivating force for its enactment. Despite its origins, however, in the intervening years, tax policy has driven the principal changes in the pension system, resulting in increasing conflict between tax and labor aspects of pension policy. From the Revenue Act of 1978 through the Economic Growth and Tax Reform and Relief Act of 2001, there were more than twenty pieces of major legislation that changed pension law, typically through changes in the tax code (even where parallel ERISA provisions were also adopted). This dominance of tax over labor aspects in pension policy is not absolute, of course. For example, attention has been devoted to participants' diversification rights and fiduciary responsibilities in the aftermath of the Enron and WorldCom problems. On the other hand, the larger conflict in pension policy over much of the past thirty years has not been the schism between 'tax' and 'labor' policy but, rather, has been the tension between tax legislation enacted primarily for revenue raising purposes, and tax legislation enacted for retirement income security purposes.

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This point was made clearly during the 1980s and early 1990s, when much pension law was enacted in an effort to address substantial federal budget deficits rather than driven by the need to boost saving. Moreover, much of the legislation designed to curtail the federal tax revenue loss attributable to tax-qualified pension contributions³ was enacted intermittently between *other* bills designed to shore up the funded status of pension plans.⁴ This somewhat schizophrenic pattern exposed the absence of any coherent retirement income policy, and it also made evident the conflict between tax policy limiting lost tax revenue and tax policy protecting pension benefits. These problems were mitigated somewhat in the mid to late 1990s as the transformation of budget deficits into surpluses eased efforts to enact nearly annual tax measures curtailing tax expenditures accorded to pensions. In addition, the stronger economy until 1999 produced better funded plans and less need to legislate improvements in funding standards.

It would be unfair to attribute the revenue loss versus retirement security conflict in the pension system entirely to the regulatory environment. Some have observed that, among plan sponsors themselves, the various corporate functions which direct pension policy have not always worked in harmony. The corporate model has been compared to that of a car in which (a) the head of human resources is the driver, with a foot pressing the accelerator in the hope of providing progressive and generous benefits to workers and retirees; (b) the chief financial officer is a concerned passenger in the front seat leaning over and trying to apply the brakes and control costs; and (c) the company actuary is sitting in the back seat, looking out the rear window giving the other two directions. In recent years, the finance concerns of plan sponsors have often taken a 'front seat' role in the determination of companies' pension decisions, as witness some firms freezing pension accruals in light of the long-term uncertainty about the interest rate that will be required for calculating defined benefit (DB) plan liabilities.

While it would be imprudent of Congress and policymakers to dismiss the cost implications of the pension system and proposed retirement policy, many run the risk of understanding the *cost* of pensions much better than they understand their *value*. This is in part the result of extensive government focus on the tax revenue loss implications of pensions, with the annual publication of pension tax expenditure and calculations of federal revenue estimates by the Congressional Joint Committee on Taxation. Any serious effort to reinvent the pension paradigm will require much more concerted attention to questions that have been all but ignored to date. These are issues such as proper balancing of interests between the major stakeholders in the retirement system—individuals, employers, and the government; better definition of the adequacy of retirement; and benefits and drawbacks of different types of retirement vehicles.

The current economic environment and the resurgence of federal budget deficits may once again threaten the tax-favored treatment of employer-sponsored retirement plans. But if the tax expenditure accorded to pensions—the second biggest expenditure in the federal budget⁵—has been responsible for frequent Congressional efforts to reduce revenue loss through changes in retirement plans over the past thirty years, that dynamic is very likely to change over the next thirty years. For the entire period of time since ERISA's passage, the baby boomer generation has been in the workforce; the tax qualified contributions made to the retirement plans of this sizable segment of the population have dwarfed the taxable retirement benefits paid out to the smaller generation that preceded the boomers. Thus, the tax exclusion for contributions to retirement plans has exceeded the taxes collected on retirement benefits, resulting in the large expenditures. But as the boomers now begin to receive retirement benefits and pay taxes on them, these trends might reverse, and the tax structure accorded to the private retirement system may become a revenue raiser. Regardless of whether that occurs, the challenge for retirement policy in the next several years—in periods of surplus or deficit—will be largely the same: to resist formulating policy based on the revenue implications alone, but rather on the basis of what will be required to ensure retirement income security for an aging population. Clearly, the task will be made much more difficult if large deficits persist, but greater difficulty should not be permitted to interfere with the fundamental necessity of the task.

This effort will require that Congressional tax-writing committees will work in concert with the labor committees, with whom they share an interest in retirement income security. This will not be easy, as it will require collaboration over corresponding changes in both ERISA and IRC provisions. This represents a golden opportunity that public policy makers will have to address the really important questions about the future of the retirement system and retirement security.

The Relevance of Expectations

The pension system has not lacked for controversy over the course of the past several years, so it would be unrealistic to think that the future will be free of controversy or debate over the nature of the pension promise. But a new better-functioning retirement paradigm can be one in which constituencies with different perspectives and agendas make a more concerted effort to appreciate each other's expectations.

The current debate over hybrid pension plans represents a good example of where the retirement policy environment would benefit from more recognition of others' expectations. In large measure, the controversy over transitions from traditional DB to hybrid plans erupted over the

issue of whether future benefit accruals could change: that is, whether the employer could modify the benefit that workers expected that they would receive if they continued to work and the plan remained unchanged. For critics of hybrid plans, the answer was an emphatic 'no', while hybrid plan advocates maintained that the law protects pension rights earned up until a certain point, but it provides no guarantee of future benefit accrual. Without delving into the details, it is plain to see that on one level, at least, the dispute is one of 'expectations'. Workers have expectations that certain conditions and events will transpire (e.g. their continued employment and the continuation of their company's pension plan). Correspondingly, plan sponsors have an expectation that they will continue to have the flexibility to change the design of their plan without being legally bound to pay benefits beyond those accrued.

It may be that these two competing expectations cannot be reconciled and will, instead, have to be resolved in the courts or in the public policy arena. Indisputably, however, the public discourse over such fundamental questions would be far more civil and productive if each side of the debate began by recognizing the other side's legitimate and competing expectations. It is possible, for example, that a hybrid plan advocate would insist that in a vibrant voluntary pension system, plan sponsors must have absolute flexibility to change their plans prospectively; while at the same time they may still acknowledge that such flexibility could be contrary to plan participants' expectations. Similarly, a hybrid plan critic would advocate that continuing certain pension plan features is more important than plan sponsor flexibility; while at the same time, they might acknowledge the harm that will be done to plan sponsors, or other participants, if employers are denied that flexibility. In practice, however, debates over the key pension questions are rarely posited to acknowledge the legitimacy of the other side's view. It is never done in a litigation context, and it seldom occurs during the course of legislative or regulatory debate.

This hybrid plan example is merely illustrative of the broader problem that plagues the retirement system debate. Of even greater concern than the resolution of any single individual policy issue is the need to make meaningful progress toward the reinvented retirement paradigm. Without a more honest recognition of others' reasonable perspectives, the nation is unlikely to make much progress on difficult retirement policy questions nor achieve the appropriate balancing of interests among participants, plan sponsors, the government, and other pension stakeholders.

To successfully implement this proposal, each of the competing interests in the retirement system debate will need to develop confidence that they can publicly acknowledge the legitimate views of others without concern that that recognition will be portrayed as a lessening in the advocacy of their position. What can be done to overcome the mistrust that often interferes with the willingness of competing interests in the retirement

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system to acknowledge the viewpoints and expectations of others? Initial confidence-building measures might include efforts by the media to portray in a balanced fashion competing interests involved in a variety of pension decisions. In addition, perhaps all advocacy groups could be asked, when making the case for their own agenda, to acknowledge where their own positions may be perceived as contrary to the interests of others. For example, all negotiating sessions could begin not only with a list of demands from each side, but also a rendition of each side's understanding of the other side's concerns and objectives. These measures are worth trying as a means of breaking long-standing logjams and thinking creatively about a new retirement policy paradigm.

The Need for Retirement Policy Champions

Virtually every history of ERISA portrays in glowing terms the statesmanship of a cadre of strong legislative leaders from both political parties.⁶ These lawmakers possessed the vision about the need for a comprehensive law to regulate the pension system, and they also diligently immersed themselves in the minutiae of the statutory provisions needed to bring to fruition what ultimately became ERISA.

It is unfortunate that the last thirty years have produced only a handful of members of Congress who could genuinely be called legislative champions of the pension system. This is despite the prominent role that pensions play in our economy, and despite the fact that retirement security is frequently a rallying cry in congressional and presidential campaigns. Only very recently have a few members of Congress moved to lay claims to this moniker. Perhaps this change is a reflection of the aging of the workforce and the growing awareness of the need to address the demographic realities that will make retirement policy an even more prominent issue on the domestic policy agenda.

Nonetheless, the paucity of pension champions may be due to the extraordinary complexity of pension law and the difficulty of mastering what has obviously become very detailed subject matter. It may also be due to the fact that for about half of the past thirty years, Congress has struggled with substantial budget deficits. Consequently, most pension legislative activity emerged from efforts to curtail the pension tax expenditure in order to either reduce federal budget deficits or help pay for cuts in other more visible types of taxes, or both.

Whatever the reasons for the past dearth of pension legislative champions, it is difficult to imagine how positive pension policy in the future will emerge unless more members of Congress make pension issues a personal priority. There are simply too many natural obstacles to thwart forward motion on retirement policy development—tax revenue implications, jurisdictional battles between and among committees with authority over

pension policy, the difficulty of mastering intricate details of pension law, and the political reality that the benefit of some pension changes are not felt, and therefore cannot be confirmed, until many years into the future. The success of prudent pension policy is often measured not in the positive conditions that it creates but, rather, in negative conditions that it prevents from occurring.

A shortage of pension legislative champions has resulted in at least two significant casualties. At the micro level, there is a lack of consistency among many of the statutes approved by Congress. At a macro level, it has resulted in the absence of a coherent national retirement income policy. The value of having retirement laws that are consistent with one another is self-evident. The arguments in favor and opposed to developing a national retirement income policy are much more complex and nuanced—and developing such a policy would be much more difficult to achieve even if there were widespread agreement that it should be done.

The challenge, therefore, is for those interested in a robust retirement system to engage in a dialogue with thoughtful members of Congress, of both parties and in both houses. Convincing lawmakers to do so should be a somewhat easier task in the years ahead than it has been in the past, because the demographic realities of an aging population and the growing emphasis on retirement policy issues in the media means that pension policy issues are much more important to the public discourse and, therefore, to elected officials.

To cultivate a larger group of retirement policy champions who will be effective, regardless of the particular agenda that they may wish to advocate, it also will be necessary to persuade more future political leaders that it is worth their while. They will have to learn the intricacies of pension policy sufficiently well that they can earn the respect of their colleagues who will *not* be retirement policy leaders, but who will rely upon the leaders' judgment in making some extraordinarily difficult decisions. It is a tall order, but it is necessary to reinvent the retirement paradigm.

Endnotes

1. Employee Plans Compliance Resolution System, Revenue Procedure 2003-44; Voluntary Fiduciary Correction Program, RIN 1210-AA76, March 28, 2002.
2. USC Sections 561-570. The Negotiated Rulemaking Act authorizes and encourages a process wherein, in real time, the disparate views of multiple interested parties and the regulators can be discussed. Apart from some Pension Benefit Guaranty Corporation rulemaking, however, the negotiated rulemaking process has been rarely employed in the development of pension regulations. It might be tried more frequently by the US Department of Labor and the Internal Revenue Service to see whether it leads to an improved pension regulatory framework. At a minimum, it might lead to a regulatory system in which interested parties more fully understand and accept the outcome of the rulemaking process. This

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approach, by itself, would not represent the reinvention of a retirement regulatory paradigm. But it could offer one possible tool for building it.

3. These include the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), Deficit Reduction Act of 1984 (DEFRA), Tax Reform Act of 1986 (TRA '86), and the Omnibus Budget Reconciliation Act of 1993 (OBRA '93).
4. These include the Single Employer Pension Plan Amendments Act of 1986 (SEPPAA), Omnibus Budget Reconciliation Act of 1987 (OBRA '87), and the Revenue Reconciliation Act of 1990.
5. Estimates of Federal Tax Expenditures for Fiscal Years 2004–2008, Joint Committee on Taxation, December 22, 2003.
6. See for instance Sass (1997).

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Chapter 3

Reality Testing for Pension Reform

Pamela Perun and C. Eugene Steuerle

I'm staring at documents that make no sense to me, no matter how many beers I drink. . . . Apparently I have until Sept. 30 (in most instances) . . . to comply with something (but what?) called 'GUST' . . . [for my Keogh plan and I] . . . must adopt EGTRRA prior to the end of the plan year beginning in 2002. I am, frankly, reluctant to adopt anything called 'EGTRRA,' which sounds like the name of a giant radioactive chicken that destroys Tokyo . . . the federal Tax Code is out of control. . . . It's gigantic and insanely complex, and it gets worse all the time. Nobody has ever read the whole thing. IRS workers are afraid to go into the same ROOM with it. They keep it locked in the basement, and once a day, they open the door, heave in a live taxpayer—some poor slob who failed to adopt EGTRRA in time to comply with GUST (and various other amendments)—then slam the door shut, before the screams start (Barry, 2003).

As humorist Dave Barry has pointed out, the US private pension system *is* fair game for jokes and ridicule. It is absurdly complicated and incomprehensible. Relevant tax rules and regulations include more than 3,000 pages of small, single-spaced, text and weigh more than most laptop computers. The companion labor rules under the Employee Retirement Income Security Act (ERISA) of 1974, are smaller, but not by much. There is widespread agreement that the present situation is untenable and something must be done. There is also widespread recognition that the aging of the baby boom generation will place the US private pension system under unprecedented pressure and that a comprehensive review of pension policy is long overdue (Mulvey and Nyce Chapter 7). As Klein (Chapter 2) notes, reinventing the retirement paradigm requires examining whether the current US private pension system can meet the retirement income challenges to come.

Analyses of the US private pension system typically focus on such issues as how to improve coverage or encourage saving or prevent tax abuse or generate retirement income more equitably. Those issues are important, but this chapter takes the position that reinventing the retirement paradigm will require more fundamental analysis. A critical step in the analysis is to step back and examine closely the architecture of the private pension system today. The structure and machinery of the private pension system, that is, the accumulation of plan types and rules over the past sixty years,

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have much to teach us about directions for reform. Accordingly we focus on the nuts-and-bolts of the private pension system, the plans that comprise it and the rules that govern them.

This is an opportune time for such an analysis. For perhaps the first time, there are two very different types of proposals for change before Congress. The first is reflected in the Pension Preservation and Savings Expansion Act (PPSEA) introduced in 2003 by Representatives Portman and Cardin (Portman and Cardin 2003*a*, 2003*b*). PPSEA is the 'traditional' type of pension reform, an omnibus bill that tinkers with almost every aspect of the private pension system to make incremental changes. The second proposal is the attempt of the Administration to effect radical change and simplification in the structure of the private pension system. The 2003 proposal, modified in budget submissions in 2004; contemplates a sweeping consolidation in the number and types of defined contribution (DC) plans (Purcell 2003; US Department of the Treasury 2004). This chapter evaluates these two approaches to change; the first one for incremental change, and the second one involving greater structural reform, and then it considers an alternative.

The Current Structure of the US Pension System

As a starting point, it is helpful to take an overview look at the current structure of the private pension system in the USA. Most people understand that the system is composed of defined benefit (DB) and DC plans, but few are aware that, legally speaking, there can be as much diversity within these types of plans as between them. Figure 3-1 illustrates the extraordinary constellation of plans that will be available when all changes brought about by Economic Growth and Tax Relief Reconciliation Act (EGTTRA) of 2001, the most recent major pension reform law, have become fully operational in 2006 (see Glossary for terminology).

The US private pension system evolved into its current complicated structure as the result of two primary factors. First, it is a tax-based system that provides tax incentives to promote saving for retirement. Second, it is a voluntary employer-based system: employers are encouraged, but not required, to provide plans for their employees. In this framework, different types of employers are subject to different tax rules. For example, for-profit and not-for-profit employers are subject to completely different sections of the federal tax code, while governmental employers are largely exempt from such rules. The theory has been that, if pension plans are to be sponsored by different types of employers, those plans should be subject to as many different rules as are necessary and appropriate for those employers. This emphasis on the tax attributes of employers largely explains the historical evolution of the private pension system. It began in the 1920s with special tax rules for plans sponsored by corporate employers.

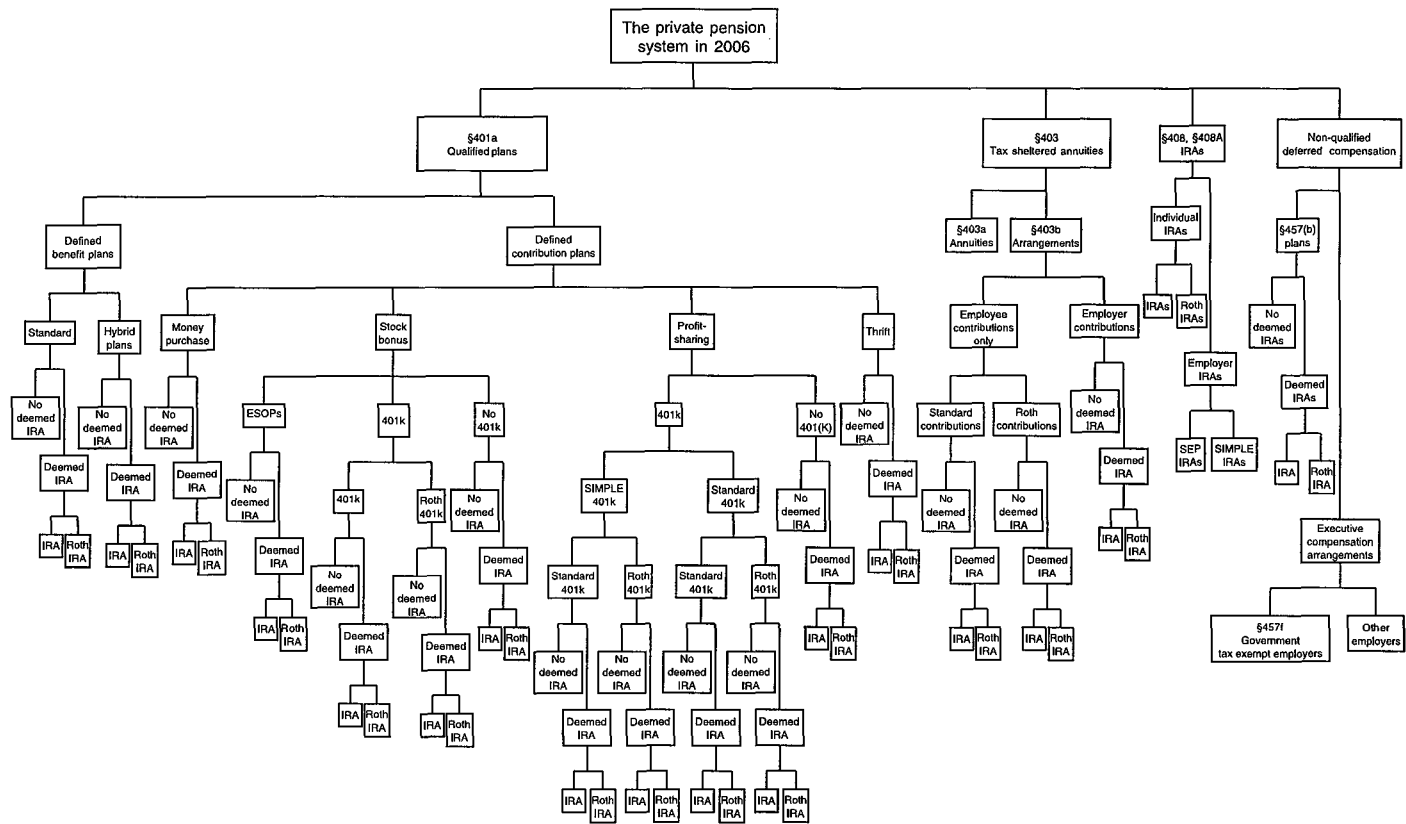


Figure 3-1. Plan types available in 2006 in the US private pension system.
 Source: Perun and Steuerle (2000) (revised for EGTRRA).

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Some twenty years later, new types of plans for not-for-profit employers were created. Next, special plans for self-employed individuals were developed, and then rules were imposed on plans for governmental employers. With the passage of ERISA, individual retirement accounts or IRAs were created, almost as an afterthought, to give workers without an employer-sponsored plan a limited opportunity to save for retirement. Finally, special Savings Incentive Match Plan for Employees (SIMPLE) plans have recently been created in the hope of attracting small employers to the private pension system. These are DC plans with safe harbor provisions designed to reduce the regulatory requirements of sponsoring a plan to a minimum.

The historical evolution of the private pension system is reflected in the post-EGTTRA arrangement of plan types composed of three primary families of plans. The largest group consists of qualified DB and DC plans subject to IRC § 401(a) that are subject to the full panoply of tax and ERISA rules. Although these plans were originally developed for corporate employers, now, with a few exceptions, any employer can sponsor these types of plans. The second group consists of tax sheltered annuities that must satisfy IRC § 403(b). These plans continue to be limited to nonprofit employers and public educational institutions. As might be expected, these plans are subject to much less regulation than their 401(a) counterparts. The third group consists of IRA-based plans under IRC § 408. Although IRAs were originally intended to be substitute savings plans for individuals without an employer-sponsored plan, employers can now offer group plans using these accounts. These plans are designed to minimize the regulatory burden on employers. Finally, there is a small, special category of plans available largely to governmental employers under IRC § 457(b).

Although each family of plans has its own specific rules, there has been some convergence over time. For example, most of the special rules for plans available to the self-employed have been repealed, and IRA-based plans are now available to employers as well as employees. In addition, some of the rigid barriers between plan families have been relaxed. Both nonprofit and corporate employers may sponsor 401(k) plans although governmental employers may not. This convergence, however, has not resulted in much simplification because, in most respects, the plan families retain their historical structures and traditional rules. As the pension system evolves, special rules and exceptions are created when the traditional rules do not fit a new situation. Over time, this process has produced a vast and complex array of rules that are increasingly difficult to navigate, even by the most experienced legal practitioner. These rules, which are illustrated in Table 3-1, include the EGTTRA changes that became effective in 2004.

As the US private pension system has grown more complex, both employers and workers find it more difficult and more expensive to navigate.

TABLE 3-1 Rules of the US Private Pension System in 2004

	IRC § 401(a) Plans					IRC § 403(b) Arrangements
	Defined benefit (DB)	Money purchase	Profit-sharing, stock bonus, Standard 401(k)	Profit-sharing, stock bonus, SIMPLE 401(k)	Other Profit-sharing or stock bonus with no 401(k)	Employee stock ownership plan (ESOP)
Eligible employer	Any employer	Any employer except state & local governments	401(k) eligible employer with <100 employees and no other plan	Any employer	Corporate employer	Tax-exempt organizations and public schools
Overall annual limits	Annual benefit limit, per person, is the lesser of \$165,000* or 100% × the highest 3 years' pay	Annual contribution limit, per person, is the lesser of \$41,000 ^{a*} or 100% of pay	Per person, same as money purchase + 401(k) contributions up to a maximum of \$13,000*	Annual contribution limit, per person, is a 401(k) contribution up to a maximum of \$9,000* + the employer contribution \$205,000*	Same as money purchase	
Pay limit						
Required employer contribution	Amount for funding current + past service costs for each employee over future service OR the normal costs of the plan + past service liability amortized over 10 years	Amount required by plan formula	None	Employer matching contribution up to 3% of pay or fixed 2% of pay contribution	None, usually	

(Continued)

TABLE 3-1 *Continued.*

	IRC § 401(a) Plans						IRC § 403(b) Arrangements
	Defined benefit (DB)	Money purchase	Profit-sharing, stock bonus, Standard 401(k)	Profit-sharing, stock bonus, SIMPLE 401(k)	Other Profit-sharing or stock bonus with no 401(k)	Employee stock ownership plan (ESOP)	IRC § 403(b)
Employee contribution limits	Amount required by plan formula, if any	Not permitted	Maximum contribution of \$13,000* + \$3,000* catch-up contribution if or age 50+	Maximum contribution of \$9,000* + \$1,500* catch-up contribution if age 50+	Not permitted	None, usually	Same as standard 401(k)
Employer deduction limits	Lesser of 165% of current liability or accrued liability minus lesser of value of plan assets or their actuarial value	25% of aggregate employee pay	25% of aggregate employee pay (excluding 401(k) contributions)	Greater of contributions (excluding 401(k) contributions) up to 25% of aggregate employee pay or required contribution	Same as money purchase	Same as money purchase + certain dividends and interest on any loan	Not applicable
Exclusions from social security tax	Both contributions and distributions		Not for 401(k) contributions but other contributions and all distributions qualify		Yes	Yes	Not for employee contributions but employer contributions and all distributions qualify
10% Early withdrawal tax				Yes			

In-service withdrawals	Not permitted		Financial hardship ^b , minimum 2 year holding period for employer contributions, loans		Minimum 2 year holding period, loans		Financial hardship, loans	
Nondiscrimination rules (not governmental plans)	Top-heavy, coverage and non-discrimination rules		ADP, ACP, top-heavy, coverage and non-discrimination rules ^c		Can be exempt from top-heavy rules; no ADP, ACP or non-discrimination rules		Top-heavy, coverage and non-discrimination rules	
Integrated with social security	May be		May be (not 401(k) contributions or matching contributions)		No		May be	
Spousal protection	Survivor annuity, consent and death benefit rights				Only death benefit usually ^d			
Vesting	Deferred		Immediate for 401(k) contributions; all others deferred		Immediate		Deferred	
Special requirements	PBGC guarantee and premium of \$19 per participant		Minimum funding required in full each year		Special vesting rules for matching contributions		None	
							Forfeitures/interest payments raise annual contribution limit if 1/3 of contributions are for HCEs; 100% employer securities allowed; diversification optional at 55; put option/voting rights.	
							Special catch-up contributions permitted with 15+ years of service	

(Continued)

TABLE 3-1 *Continued.*

	IRC §408, 408A IRAs				Non-qualified deferred compensation plans	
	<i>Traditional IRA</i>	<i>RothIRA</i>	<i>SEP-IRA</i>	<i>SIMPLE IRA</i>	<i>Eligible 457(b) plans</i>	<i>Executive Arrangements</i>
Eligibility	Anyone	Anyone with earnings less than \$110,000 for individuals and \$160,000 for couples ^e	Any employer	Employees of employers with no other plan and <100 employees	Employees of state and local government and tax-exempt organizations	Select group of officers or highly compensated employees
Dollar limit on contributions	\$3,000* for all IRAs + \$500* catch-up contributions; contributions are fully deductible if there is no employer plan or income is less than \$45,000 for individuals and \$65,000 for couples ^f	\$3,000* for all IRAs + \$500* catch-up contributions	Lesser of \$41,000* or 25% of pay	Amount of employee and employer contributions	\$13,000* + \$3,000* catch-up contributions	None
Maximum per cent of pay limit on contributions	100%	100%	25%	Not applicable	100%	None
Employer contribution limits		Not applicable	Lesser of \$41,000* or 25% of pay	Matching contribution of up to 3% of pay or fixed contribution of 2% of pay		None
Employee contribution limits	\$3,000* + \$500* catch-up contributions	\$3,000* + \$500* catch-up contributions	Not applicable	\$9,000* + \$1,500* catch-up contributions	Lesser of \$13,000* + \$3,000* catch-up contributions or 100% of pay	None
Employer deduction limits		Not applicable	25% of aggregate pay	Amount of contributions	Not applicable	None

Exclusion from SS tax	Not for contributions but distributions qualify		Both contributions and distributions	Not for employee contributions but employer contributions and distributions qualify	Not for employee contributions but distributions qualify	Depends on vesting
10% Early withdrawal tax	Yes	Usually not	Yes	Yes, increased to 25% in 1 st 2 years	Not applicable	No (unless annuity purchased)
Early withdrawal tax exceptions	Medical, 1st home-purchase, higher education expenses, health insurance payments for unemployed	Age 59½, death, disability, 1st home purchase	Same as traditional IRA	Same as traditional IRA	Not applicable	None (unless annuity purchased)
Withdrawals permitted	Yes, may be subject to excise tax	5-year waiting period	Yes	Unforeseeable emergency only while employed	Yes	
Loans available	No				Unclear	Yes
Nondiscrimination rules	None	None	Uniform percent of pay contribution; top-heavy rules	Required employer contribution only	None	None
Pay limit	See above		\$205,000*	\$205,000* for 2% of pay contribution	\$205,000*	Not applicable
Integrated with social security		No	May be	No		Not applicable
Spousal protection			None under federal law, may be available under state law			
Vesting			Immediate			Usually deferred

(Continued)

TABLE 3-1 *Continued.*

	IRC §408, 408A IRAs			Non-qualified deferred compensation plans		
	<i>Traditional IRA</i>	<i>Roth IRA</i>	<i>SEP-IRA</i>	<i>SIMPLE IRA</i>	<i>Eligible 457(b) plans</i>	<i>Executive Arrangements</i>
Special restrictions and benefits	None	After-tax contributions; no tax on distributions	Employer does not have to contribute every year	Employees are generally responsible for investments	Special double catch-up contributions available during the 3 years before retirement; plans are technically unfunded but contributions to public sector plans must be held in trust	Employee taxed when benefits are paid or made available (or when vested for tax-exempts); may be a DC or DB plan

*means the amount is subject to adjustment for inflation or through a scheduled increase.

Source: IRC §§ 219, 401(a), 401(k), 401(m), 402, 403, 404, 408, 408A, 409, 410, 411, 412, 414, 415 and 416 and their regulations.

^a The \$41,000 overall limit is a cumulative limit for an employee across all defined contribution plans of the same employer.

^b Financial hardship is an immediate and heavy financial need, even if foreseeable or voluntarily incurred, not able to be satisfied by other resources.

^c Both the Actual Deferral Percentage (ADP) test for 401(k) contributions and the Average Contribution Percentage (ACP) test for matching and after-tax contributions are designed to limit contributions made by HCEs to a proportion based on the average contributions made by NHCEs.

^d The surviving spouse receives the account balance as a death benefit unless he/she has consented to another beneficiary being named.

^e The income phase-out schedule for Roth IRAs is \$95,000–110,000 for individuals and \$150,000–160,000 for married couples filing jointly.

^f IRA income phase-out schedule in 2004: \$45,000–55,000 for individuals and \$65,000–75,000 for married couples filing together. These phase-outs are scheduled to increase to \$50,000–60,000 for individuals and \$80,000–100,000 for joint filers by 2007. There are also special limits for nonworking spouse.

For example, it is often not readily apparent in any given situation which plan might be the 'best' alternative among those available. Numerous consultants and other pension professionals assist in the plan selection and design process, but their services inevitably increase the cost of plan sponsorship and membership. Moreover, as rules grow more complicated, the administrative burden on plan sponsors whose plans must satisfy all relevant rules or lose their tax benefits also increases. The private pension system now includes a plan compliance industry, composed of lawyers, consultants, actuaries, accountants, and other pension professionals, dedicated to mastering and implementing plan rules. Their services are often critical to insure that plans satisfy the law, but their costs, which can be significant, must be borne by the employer as an additional business expense or charged to plan participants where they reduce the return to savings.

To be fair, it must be acknowledged that EGTTRA has resulted in some long overdue and welcome changes. For example, it rationalized the contribution limits on most employee savings plans today, 401(k), 403(b) and 457(b) plans, and the employer deduction limits on most plan types. It also eliminated some anomalies, such as the exclusion allowance for 403(b) arrangements and the coordinated contribution limit for 457(b) plans. It will result in one less plan type to worry about; by increasing the deduction limits for profit-sharing plans to those of money purchase plans; the latter (which are slightly less flexible) will become extinct. But, of course, most plan types continue to operate and the private pension system must now absorb and digest the changes EGTTRA has made in pension law.

The type of reform represented by EGTTRA and its predecessors have generally left the private pension system with more rules, not fewer; more plan types, not fewer; and more choices, even though many are not meaningful or worthwhile if and when understood. Only in a very few cases, such as the repeal of special contribution limits for 403(b) arrangements, did some rules actually disappear. In most cases, new rules are just placed on top of old rules, and new regulations must be written to harmonize and integrate them with existing law. Moreover, the private pension system has not yet felt the full brunt of EGTTRA. Rules permitting IRA contributions to employer-based plans recently became effective, and in 2006, some plans will be allowed to provide eternal tax forgiveness of future returns as long as no upfront deduction is taken, essentially by permitting the Roth-type contributions available already for Roth IRAs.

Given this background, not all of EGTTRA's changes are as benign as they might first appear. Allowing IRA contributions to be made to employer-based plans (thereby letting employees make these contributions directly to their employer's plan rather than to a separately maintained IRA) might be viewed as a good idea. Dodging the budgetary implications of backloading the cost of tax preferences to future years, allowing Roth-type contributions to employee savings plans (e.g. Roth 401(k)'s in 2006)

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might also be viewed as worthwhile in isolation as a pension policy. From a legal perspective, however, these additions compound the complexity now found in the private pension system. IRA contributions to qualified plans ('deemed IRAs') bring with them their special rules that will be added to plans already overwhelmed with their own rules. A plan that fails to observe the IRA rules may jeopardize the tax-qualified status of the entire plan while a plan that violates tax-qualification requirements may cost its IRAs their tax benefits too. Roth contributions too make employer-plans more complicated. Employees have traditionally made contributions on a pre-tax basis through which contributions (and their earnings) are taxed only when distributed from the plan or on an after-tax basis in which contributions are made from already-taxed income and only earnings are taxed when distributed. Roth contributions are based on a completely different tax system in which contributions are made from after-tax income but are completely exempt from taxation thereafter. Adding Roth contributions therefore means layering a third tax system on top of the traditional pre-tax and after-tax regimes. Employers will have to observe all the separate vesting rules, separate distribution rules, and separate record keeping, tax reporting and accounting requirements that apply to these different types of contributions and tax regimes in their plans. The ultimate effect of even the best-intentioned changes brought about by EGTTTRA is more, not less, legal complexity in the private pension system and more, not less, of a compliance burden for employers.

Maintaining the Status Quo: The Pension Preservation and Savings Expansion Act of 2003

According to its sponsors, the PPSEA, makes 'the next generation of improvements to our nation's savings and pension systems' by providing 'a number of important new savings tools,' strengthening and expanding the employer-sponsored retirement system, offering 'new protections to participants' and 'assisting retirees in managing and preserving retirement assets and income' (Portman and Cardin 2003*a*). It is a massive bill, with more than 200 pages and 16 lengthy sections of highly technical changes to employee benefits law.¹

PPSEA follows in the footsteps of EGTTTRA and was crafted as a follow-on bill by EGTTTRA's primary drafters, US Representatives Rob Portman of Ohio and Benjamin Cardin of Maryland. Its initial thrust was to accelerate and make permanent the changes in EGTTTRA that would have expired in 2010 unless extended by Congress. Its immediate effect would be to increase the amounts individuals could contribute to 401(k)-type plans and IRAs. The bill then winds its way through almost every aspect of the private pension system, proposing changes, additions, and deletions to current rules along the way. If PPSEA were to be enacted, major legal rules

throughout the pension system will be changed. These include rules on when employees are vested in plan benefits, when plans become tax-qualified, how DB formulas can calculate pension, and when employees must begin receiving benefits.

In addition to rule changes, there are, as always, changes to plan types. This time, the focus is on the SIMPLE plans created in 1996 that were based on plan designs intended to minimize the regulatory burden of sponsoring a plan for small employers. When SIMPLE plans were enacted, employers were no longer permitted to create new Salary Reduction Simplified Employee Pension Plans (SARSEPs), plans that could be restricted to employee, 401(k)-type contributions. SIMPLE plans required employers instead to make at least a minimal plan contribution in exchange for fewer rules and less liability. PPSEA proposes to weaken the effect of these reforms by bringing back SARSEP-type plans and permitting a smaller employer contribution. Employers would have more choices but the design of SIMPLE plans would become more complicated and, in the end, not very different from their traditional counterparts.

Not one of these changes, standing alone, is particularly problematic, and many are in fact improvements in current rules. But perhaps this is not the appropriate standard for evaluating PPSEA. The important question is not whether it does some good for some people, but rather whether it helps move the private pension system toward the systematic improvement it needs to meet the retirement income challenges to come and whether it makes the best use of the resources that are spent. A more general question is why the private pension system seems to need major reconstructive surgery every year or so. After every extensive legal revision, it usually takes about five years before the necessary regulatory guidance to implement the new rules is available. Too frequent changes leave plans in legal limbo and the system in regulatory gridlock.

PPSEA tinkers with many current rules and adds new ones but does little to change the basic architecture of the private pension system. For example, there will still be eight different ways for employees to save their own money, depending on what type of employer they have and the plan it chooses to sponsor, if any: a 401(k) plan for corporate and nonprofit employers, a 403(b) arrangement for nonprofit and public employers, a 457(b) plan for nonprofit and public employers, a SIMPLE plan based on a 401(k) model, a SIMPLE plan based on an IRA, a traditional IRA, a Roth IRA, or a SARSEP. For employers, distinguishing 401(k) plans from 403(b) arrangements from 457(b) plans from SIMPLE plans will be difficult, because they will outwardly look so much alike. Employees, too, often find the intricate rules for saving perplexing. When navigating the private pension system, employers and employees are confronted with choices that appear similar but can have very different legal consequences, and this, as lawyers often say, can and will be a trap for the unwary.

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EGTTRA and PPSEA exemplify the customary approach to reform in the US private pension system. For the most part, they maintain the status quo and preserve the historically distinct plan types based on employer tax attributes and their rules. At the same time, they create new plan types and tax regimes that do not fit neatly into the traditional structure. Over time, the traditional structure makes less sense and becomes less capable of supporting such changes; systemic reform is warranted but never achieved. Instead, plan types continue to be haphazardly combined, and their rules are layered on top of each other, along with the many special rules and exceptions and transition rules and historical legal quirks required to maintain the legal integrity of the system. The consequence is an all too complex and intricate private pension system.

One consequence of this approach is, frequent mutations of pension law that increase the compliance burden of employers as well as the costs of sponsoring a plan. On the positive side, it may provide employers and employees with more choices. Then again, while more choice is usually good, too many unnecessary choices may not be desirable especially if, over time, they are not sustainable. For example, adding Roth contributions will increase the complexity and cost of plan administration for employers and be a likely source of confusion for employees (Vanguard Center for Retirement Research 2001). Not only do Roth contributions require employees to project future earnings, tax rates, and statutory changes to tax law when deciding about contributing, but the tax consequences of their choice will determine pension and budget policy in part for decades to come. There is no guarantee, moreover, that Roth contributions will always have the favorable tax treatment they now enjoy. Employees, even assuming they can make a perfectly rational choice between the alternative tax regimes, may find that new tax laws (e.g. higher rates, lower rates, adoption of a consumption tax) means that the government reneged on what it once offered. It is one thing to change the law; it is another to give people choices, and then change the rules under which those past choices were made. And when eligibility for future Medicare, Medicaid, and other income-related benefits are determined, 'income' from Roth IRAs and 401(k)s probably will be counted, meaning that employees will have to maintain mini-accounting systems just for Roth contributions, even though they do not need to be reported for income tax purposes.

Ultimately, the question arises: Who really benefits from PPSEA and the type of change it represents? It certainly means more work for the lawyers, actuaries, consultants, and accountants in the plan compliance industry. New regulations must be drafted, plans must be rewritten and requalified, and administrative procedures must be reprogrammed. PPSEA also means more assets of higher-income individuals will need to flow through an extra layer of retirement plan management, thus increasing the fees paid to financial services, mutual fund, and insurance companies relative to other

saving. It means that wealthier Americans can get more tax benefits from savings plans sooner because of higher contribution limits and liberalized withdrawal rules. Further, there are many special rules and provisions for almost every large group with an interest in pensions. But it is difficult to argue that it is constructive for the ordinary pension consumer—the not-so-large employer and the not-so-wealthy employee—from whom the higher costs of management attributable to the added complexity will take a much larger share of savings. For many of them, net rates of return are likely to decline. Neither have its economic benefits been demonstrated; there is no evidence (and no one has attempted to estimate) that PPSEA would result in any increase in the percent of low-and middle-income workers who reach retirement with perhaps more than \$100,000 in assets.

An Alternative Direction for Private Pensions? Simplified Savings Accounts

In 2003, the Bush Administration stunned the employee benefits community by proposing a radical pruning of employer-sponsored savings plans. It advocated replacing the panoply of 401(k) plans, 457(b) plans, SIMPLE 401(k) plans, 403(b) arrangements, SEPs and SIMPLE IRAs with a new, standard plan type called Employer Retirement Savings Account or (ERSA). Although ERSAs look similar to today's 401(k) plan, contributions would not be made from pre-tax income. Instead, all contributions would be Roth contributions, made from after-tax income and exempt from taxation thereafter. Traditional and Roth IRAs would also be combined into a type of plan called a Retirement Savings Account or RSAs, modeled on today's Roth IRAs, would replace individual IRAs, and a new savings arrangement called a Lifetime Savings Account or LSAs would be created for general purpose saving.² LSAs are also modeled on Roth IRAs, but would have fewer rules and restrictions than either ERSAs or RSAs. In 2004, the proposal was expanded to include a fourth type of savings plan, individual development accounts (IDAs), intended for low-income workers.

The Administration's proposals were widely criticized; many felt that RSAs and LSAs were too generous to higher-income taxpayers who could arbitrage the tax system and generate tax saving with little or no increase in personal saving (Steuerle 2003). Others felt that these would destabilize the private pension system, because employers, particularly small business owners, would trade in their broad-based plans for personal RSAs and LSAs for themselves and their families. Some suggested that employees also might abandon their employer-based plans and worried that (Profit-Sharing/401(k) Council of America 2003):

Some moderate and lower income employees will make smaller, or no, contributions to LSAs and RSAs than they and their employers would have made to their

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qualified plans. Many employees will redirect their retirement savings to LSAs and use their accumulations for nonretirement purposes. To the extent that some employers continue to offer 401(k) plans, it may be more difficult for these plans to pass the nondiscrimination tests, even as changed in the proposal. Many employees offered a 401(k) will choose instead to save in LSAs, where they will have immediate and unrestricted access to their savings.

The plan compliance industry was distressed that it had not been consulted and the proposals were developed without their knowledge or cooperation. As a result, the proposals failed to find supporters or receive serious consideration.

Yet the following year, ERSAs, RSAs, and LSAs again returned to the policy arena, and this time, the Administration actively worked with the plan compliance industry. The most recent proposals retained some of the beneficial simplification features of the 2003 design but there were also some significant differences. Table 3-2 illustrates the major design features of each plan as currently proposed and indicates important rule changes from the 2003 proposals.

One change was that RSAs and LSAs were made modestly less attractive by reducing annual contribution limits by one-third, from \$7,500 to \$5,000 annually. Otherwise, the accounts were little changed: RSAs and LSAs are still essentially Roth-IRAs, funded with after-tax contributions and largely exempt from tax thereafter. In an effort to provide a balance for RSAs and LSAs that would benefit those at the high end of the income scale, the Administration added something for those at the low end—an expansion of the still-experimental IDAs. Low-income savers could contribute to an IDA and receive a 100 percent match of up to \$500 annually. Matching contributions would come indirectly from the government through private financial institutions (not employers) that would receive a 100 percent tax credit in return for providing the match initially. Account assets would be available to pay for higher education, first-time home purchases, and small business capitalization.

ERSAs too were changed in the 2004 round. Figure 3-2 illustrates how ERSAs would reduce the current hodgepodge of savings plans—the 401(k) plans; the 403(b) arrangements; the 457(b) plans; the SIMPLE IRAs; the SARSEPs, and the SIMPLE 401(k)s—that now clutter the private pension system, to a single, standard plan. All 401(k) plans would become ERSAs, and all other plans could become ERSAs; those that did not would be frozen as of 2005. ERSAs could also include RSAs, subject to RSA rules.

This new direction proposed for the US private pension system, based on simplified savings accounts, has some significant merits that have largely been lost in the controversy over RSAs and LSAs. First, ERSAs would help rationalize and modernize the private pension system by eliminating some archaic, duplicate plan types. Second, they would simplify and standardize further, the rules for employee saving and thereby, reduce the burden and

TABLE 3-2 Proposed Rules for ERSAs, RSAs, LSAs and IDAs, 2003 and 2004

	<i>Employer plan</i>	<i>Employer or individual plan</i>	<i>Individual plan</i>	
	<i>Employer retirement savings accounts (ERSAs)</i>	<i>Retirement savings accounts (RSAs)</i>	<i>Lifetime savings accounts (LSAs)</i>	<i>Individual development accounts (IDAs)</i>
Sponsor/Contributor Eligibility	Any employer Not applicable	2004: no income limits; no age limits	Not applicable 2004: no income limits; no age limits	Single: <\$20,000* income Married: <\$40,000* income Individual contributions + 100% match up to \$500
Annual funding	Optional; pre- and post-tax employee contributions; pre-tax employer contributions (broad-based and match)	Optional; post-tax only	Optional; post-tax only	
Contribution limits	Employee: \$30,000 + \$3,000 catch-up* maximum: \$41,000* or 100% pay	2003: \$7,500* or pay 2004: \$5,000* or pay	2003: \$7,500 or pay* 2004: \$5,000* or pay	?
Exclusion from SS tax	No, employee contribution; yes, other contributions and distributions		Not applicable	?
Early withdrawal tax	Probably, same as today	2003: non-qualified withdrawals subject to income+ penalty tax 2004: non-qualified withdrawals in excess of contributions subject to income + penalty tax; 5 year holding period for conversions from ERSAs or traditional IRAs to avoid 10% penalty	No	?

(Continued)

TABLE 3-2 *Continued.*

	<i>Employer plan</i>	<i>Employer or individual plan</i>	<i>Individual plan</i>	
	<i>Employer retirement savings accounts (ERSAs)</i>	<i>Retirement savings accounts (RSAs)</i>	<i>Lifetime savings accounts (LSAs)</i>	<i>Individual development accounts (IDAs)</i>
In-service or qualified withdrawals	Probably, same as today	After age 58, death, disability	Any amount, any time	Higher education, 1 st time home purchase, small business capitalization
Nondiscrimination rules	<p>2003: no top-heavy rules, must have 70% coverage of NHCEs in plan, no integration or cross-testing rules.</p> <p>2004: current minimum coverage, top-heavy, integration, cross-testing rules apply; no ACP or ADP; if NHCEs' contributions (employer and employee) average <6% of pay, HCE contributions limited to 200% of NCHE contribution, otherwise no limit; design safe harbors if NHCEs get vested contributions of 3% of pay.</p> <p>2004: if 50% vested match up to 6% of pay, no testing; special rules for government and non-profit employers.</p>		Not applicable	
Integrated with Social Security	<p>2003: no</p> <p>2004: yes</p>			
Spousal Protection	?	?	?	?

Vesting	Immediate for employee contributions; deferred for others?		Not applicable	
Special features	<p>Consolidates 401(k), SIMPLE 401(k), 403(b), governmental 457(b)s, SARSEPs, SIMPLE IRAs.</p> <p>2003: uniform definition of HCE and compensation: HCE = pay > taxable wage base; compensation = W-2 pay + elective deferrals.</p> <p>2004: no uniform definition of HCE or compensation; Roth treatment for after-tax contributions and distributions; current rules for employee and employer contributions</p>	<p>Existing IRAs frozen but taxable IRAs could be converted (no income limits); Roth treatment for contributions and distributions.</p> <p>2004: no withdrawals for 1st home purchase, education, health expenses or unemployment; no minimum distribution rules; marital rollovers permitted; no income cap on Roth conversions</p>	<p>Roth treatment for contributions and distributions; no minimum distribution rules; can convert Coverdell accounts and 529 plans but not health savings accounts or medical savings accounts</p>	<p>Sponsoring financial institutions get a 100% tax credit for matching contributions plus a \$50 per account credit for administrative expenses.</p>

* indicates an amount indexed for inflation.

Source: Portman and Cardin (2003a, 2003b); U.S. Department of the Treasury (2004)

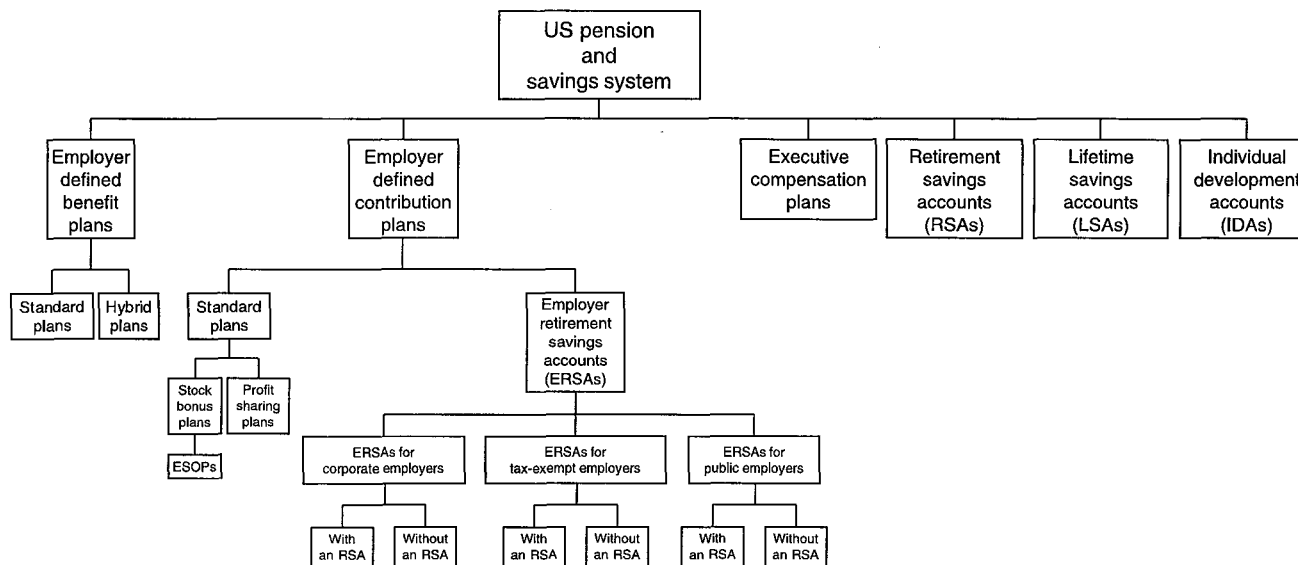


Figure 3-2. Proposed new structure for the US private pension system.
 Source: US Treasury Department (2004); IRC 401(a), 4975(e) (7).

costs of plan administration. Although a single plan for employee saving makes sense, the new proposal does not go as far as it could from a design perspective. It preserves the anachronism that some separate rules are required for different type of employers, even though ERSAs are primarily designed for employee saving. There are drawbacks from a tax perspective as well, notably the Roth-type accounts. They push all costs into the future, often for decades; they add significant complication for both planning and administration when withdrawals from traditional DB plans receive more traditional tax treatment; they disfavor middle-income employees who are likely to retire and move into lower tax brackets (for whom the traditional tax treatment is better); and, as noted above, other government programs are inevitably going to require income accounting for supposedly nontaxable Roth contribution income anyway.

In addition, while the 2004 ERSAs look much like the 2003 version, they lack many of the features with the most promise for simplifying pension law. Most plans currently must perform complicated tests against the nondiscrimination rules, to prove that they are not providing high-paid employees with excessive benefits. Last year's proposal greatly simplified those rules by providing standard definitions of key concepts and less-complicated testing procedures. It minimized the special nondiscrimination rules that 401(k) plans must pass every year to maintain a balance between contributions by high-paid and low-paid employees. It also dispensed with the top-heavy rules that come into play when plan benefits favor company owners and executives and the procedures employers can now use to shift a higher proportion of plan benefits to the high-paid such as Social Security integration and cross-testing.

The 2003 proposal promised to take the US pension system in a new direction. Through a radical pruning of plan types and their anachronistic rules, it seemed to herald a turning point in design that would reduce the administrative burden on employers and the cost of sponsoring plans. The 2004 proposal had a more limited vision. For example, the 2003 proposal retained the current nondiscrimination standard that qualified plans could not be designed or operated to favor high-paid employees but suggested simplified tests for measuring discrimination. The simplification it proposed seemed even-handed for both low- and high-paid employees. Each won and lost a little relative to the current rules but, on balance, neither seemed particularly disadvantaged by the proposed changes. By contrast, the 2004 proposal kept alive today's version of the nondiscrimination rules, that massive tangle of pseudomathematical rules, regulations, testing procedures, and special exceptions, that most qualified plans must satisfy every year. By doing so, it retained such rules as Social Security integration and cross-testing that enable employers to shift more contributions and benefits to high-paid employees. At the same time, ERSAs in 2004 offered nothing new for low-paid employees but were likely to enable

high-paid employees to contribute even more than they could under current law.

Sketching a Compromise

Although it did not pass in 2003, PPSEA seems more destined for legislative passage, since it represents a traditional approach to reform and is therefore less controversial as it makes no fundamental change to the status quo. Moreover, almost every special interest group in the retirement benefit field has a desired provision in it, and the muscle of employee benefits and financial service trade associations is behind it. Budgetary constraints, however, may prevent or slow its passage. PPSEA, like EGTTRA, was designed in the unique 1997–2003 budget period, where almost every major tax or expenditure bill included giveaways but little or no attention was paid to financing the changes.

At the same time, however, the Bush Administration's ERSA/RSA/LSA type of proposal has a support base. Although its design was initially viewed as too radical, the 2004 changes brought the plan closer to the mainstream and increased its appeal, though this may have eroded its potential for real change. In reality, the Administration's proposal was never as radical as it first appeared, but the new changes made it even less so. For example, the design of ERSAs seemed appealing for its simplicity, but it could have been improved without adding too much complexity. The 2004 changes not only failed to simplify coverage and nondiscrimination standards that keep low-paid workers from being left behind or left out, they generally were in the opposite direction.

The 2004 proposal also retained several other design flaws. For example, the Administration proposed to create different ERSAs for different types of employers. Keeping special rules for tax-exempt and governmental employers is an anachronism; the tax attributes of employers have no relevance for plans designed for employee savings, especially now that employee-funded plans are the primary, and often the only, source of retirement income for millions of workers. An employee who works for a corporation should have the same opportunity to save as an employee at a state government. A high-paid employee of a tax-exempt hospital should have no greater or lesser chance to save than a corporate employee with the same income. A related issue was the failure to design ERSAs with more incentives for savings by low-paid employees. Today's 401(k) plans, for example, have special provisions designed to increase retirement saving by low-paid employees that seem to have succeeded, so there is an argument for applying them to plans of tax-exempt and state government employers too. Another crucial reform to the ERSA proposal is to eliminate all opportunities for Roth-type contributions. As noted, they represent substantial complexity in figuring out what type of account to open, they are all

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back-loaded in costs and represent poor budget policy, and they add to complexity, with only one piece of that complexity related to the potential for conversions over time.

In Figure 3-3 we present a compromise proposal for revising ERSAs, one we first broached when ERISA turned 25. At that time it did not seem feasible in the near term, but, thanks to Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and the Administration's proposal, it no longer seems out of the realm of possibility. Like the Administration's proposal, it calls for a single, simple DC plan for employee saving, to replace the many varieties available today. It also calls for uniform contribution and deduction limits and rules on portability that have largely been achieved—thanks to EGTRRA. It provides further simplification by proposing uniform Social Security treatment for contributions, and, it ignores the tax attributes of employers when designing rules to promote employee saving.

This design also avoids the issue over which the Administration's proposal stumbled, namely overly generous individual saving vehicles which compete with employer plans, by having an individual, coordinated limit

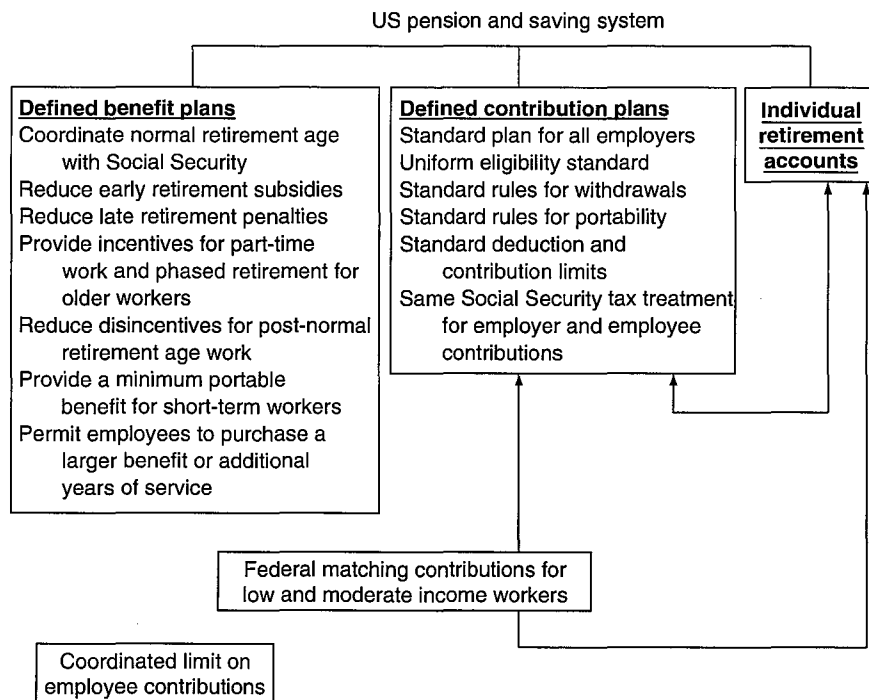


Figure 3-3. An alternative structure for the US private pension system.
 Source: Perun and Steuerle (2002).

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on saving between individual and employer-sponsored vehicles. This will not solve the coverage problem by itself; that is, there will still be many smaller employers who will find the current IRA limits an attractive alternative to sponsoring a plan. But, unlike the Administration's RSA proposal, the coordinated limit will keep this plan from becoming the Trojan horse of the private pension system.

Finally, this model recognizes that more needs to be done to make a tax-based system an effective saving tool for low-paid workers. It is unclear why major reform should be enacted, unless it promises to expand participation in the private pension system, so this alternative plan recommends government matching contributions for low and moderate-income workers just for that purpose. The fiscal realities facing the federal government today are very different, but three years ago EGTRRA created a tax credit for low-income savers that PPSEA now proposes to make available to higher-paid workers. It makes more sense to make EGTRRA's credits refundable, which would help the majority of low-income savers who have no tax liability and provide an incentive to save that is similar to matching contributions. This issue involves more than fairness. Those with little saving currently are the ones least likely to be able merely to transfer money out of one account into a subsidized retirement account. Thus government subsidies might be more likely to increase national saving as well, if they were less directed to those able to obtain the benefits of the private pension system without contributing any additional net saving.

Conclusions

The challenges facing the US pension system are well recognized. Despite large budgetary costs, the current structure does not provide substantial benefits for a very large portion of new retirees, particularly those who have had average or below-average earnings. Accordingly, Congress, and the country, is at a crossroads. Legislators can either decide to maintain the status quo, or they can strike out in a new direction.

Maintaining the status quo may seem the safer choice and may be the path chosen. Yet bolder action may be warranted. One approach, represented by the Administration's 2003 and 2004 proposals for ERSAs, LSAs, and RSAs, moves the private pension system toward a more efficient structure. The effectiveness of this design for increasing saving and plan participation, as well as its effect on the long-term budgetary situation, is open to question. An alternative model for restructuring the US private pension system takes some good ideas, along with the best elements of EGTRRA, PPSEA, and the Administration's proposals, and repackages them. At the same time, the appeal of a simple, standard, universal savings plan is that it avoids both the mind-numbing complexity of PPSEA and the budgetary costs and distributional effects of the Administration's proposal. In sum,

the private pension system does not necessarily need *more* saving tools, but rather it needs to put them to work more effectively. This is the critical first step towards reinventing the pension component of the new retirement paradigm.

Glossary

- 401(a).** IRC § 401(a), the federal tax statute containing the basic requirements for qualified DB and DC pension plans under US law.
- 401(k).** IRC § 401(k), the federal tax statute containing the special requirements for a 'cash-or-deferred' savings arrangement that enables employees to save for retirement on a pre-tax basis when contributing to their employer's DC plan.
- 401(k) plan.** A component of a qualified DC plan based on IRC § 401(k) that permits pre-tax contributions by employees. A 401(k) plan is a qualified plan.
- 403(b).** IRC § 403(b), the federal tax statute containing the primary requirements for tax-deferred DC arrangements available to employees of educational institutions and certain non-profit organizations defined in IRC § 501(c)(3). 403(b) arrangements may also permit 401(k)-type, pre-tax contributions.
- 403(b) arrangements.** A savings arrangement, also called a tax sheltered annuity, based on IRC § 403(b) that can permit pre-tax contributions by employees. A 403(b) arrangement is not a qualified plan.
- 408.** IRC § 408, the federal tax statute containing the basic requirements for IRAs and SIMPLE plans based on IRAs.
- 408A.** IRC § 408A, the federal tax statute containing the basic requirements for IRAs permitting Roth contributions.
- 457(b).** IRC § 457(b), the federal tax statute containing the basic requirements for tax-deferred DC plans sponsored by state and local governments and tax-exempt employers that permit 401(k)-type, pre-tax contributions by employees.
- 457(b) plan.** An employer-sponsored arrangement based on IRC § 457(b) that permits pre-tax contributions by employees. A 457(b) plan is not a qualified plan.
- ACP.** Average Contribution Percentage Test, one of the two primary tests for 401(k) plans that impose a ceiling on benefits for high-paid employees relative to the benefits received by low-paid employees in order to encourage their participation. The ACP test measures whether the difference between the amount of employer matching contributions and employee after-tax contributions, measured as a percentage of pay, made by NHCEs, on average, and by HCEs, on average, is within the spread permitted by IRC § 401(m).
- ADP.** Average Deferral Percentage Test, one of the two primary tests for 401(k) plans that imposes a ceiling on benefits for high-paid employees relative to the benefits received by low-paid employees in order to encourage their participation. The ADP test measures whether the difference between the amount of pre-tax contributions, measured as a percentage of pay, made by NHCEs, on average, and by HCEs, on average, is within the spread permitted by IRC § 401(k).
- After-tax contributions.** Employee contributions to an employer-based plan or IRA that are made from after-tax income so that only earnings are taxed when distributions are made from the plan.

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Catch-up. Additional contributions permitted to defined contribution plans by employees who have attained the age of fifty.

Coverage. One of the two primary nondiscrimination tests for qualified plans that are intended to insure that a plan does not disproportionately favor high-paid employees. In general, this test measures whether the plan includes a sufficient number of participants who are NHCEs relative to the number of HCEs that participate and is defined IRC § 410(b).

Cross-testing. A method of testing a qualified plan for nondiscrimination under IRC § 401(a)(4) that permits a DB plan to be tested as if it were a DC plan and a DC plan as if it were a DB plan.

Deemed IRAs. An IRA that is included within a qualified plan, a 403(b) arrangement or a 457(b) plan.

Defined benefit plan. A type of plan that pays retirement benefits, usually for life. Employees earn benefits under a plan formula usually based upon their pay and years of employment.

Defined contribution plan. A type of plan that provides an account for each participant and bases benefits on contributions to that account and its earnings.

EGTTRA. The Economic Growth and Tax Relief Reconciliation Act of 2001, the most recently-enacted tax legislation to amend employee benefits law significantly.

Employee stock ownership plan. A qualified plan that is a DC plan designed to invest primarily in employer stock, defined in IRC §§ 409 and 4975(e)(7).

ERISA. The Employee Retirement Income Security Act of 1974, the primary modern law, including both labor and tax laws that governs most US employee benefit plans.

ERSA. Employer Retirement Savings Account, proposed by the Administration in 2003 and 2004 as a simplified, uniform replacement plan for 401(k), SIMPLE and 457(b) plans as well as 403(b) arrangements.

HCE. Highly compensated employee, defined in IRC § 414(q), one of the major concepts in the non-discrimination tests that qualified plans must satisfy. In 2004, an employee who earns at least \$90,000 is an HCE.

IDA. Individual development account, proposed by the Administration in 2004 as a savings account for low-income individuals.

IRA. Individual retirement account governed by IRC § 408 and originally enacted as part of ERISA as a DC savings plan for individuals without an employer-based plan. IRAs now can be found in employer-based plans such as SIMPLE IRAs and SEPs, and, if the plan permits it, employees may also make contributions to an IRA through a traditional DC plan. An IRA is not a qualified plan.

IRC. Internal Revenue Code, the body of federal US tax law statutes.

LSA. Lifetime Savings Account, proposed by the Administration in 2003 and 2004 as a new DC account for general purpose saving.

Money purchase plan. A qualified plan that is a DC plan with a fixed contribution formula.

NHCE. A non-highly compensated employee, defined in IRC § 414(q), one of the major concepts in the nondiscrimination tests that qualified plans must satisfy. In 2004, an employee who earns less than \$90,000 is a NHCE.

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Nondiscrimination rules. The body of rules under 401(a)(4) designed to insure that qualified plans do not discriminate in favor of highly compensated employees in their plan benefits or contributions. These rules, coordinated with the coverage rules, implement the nondiscrimination standard that prohibits a qualified plan from being designed or operated in favor of HCEs.

Nonqualified deferred compensation plan. A retirement plan, usually for executives, that is not a qualified plan but is often used as a supplement to one. Plan participants are not taxed on contributions to the plan or accrued benefits until they are received or available for distribution, at which time employers receive a deduction for their contributions to the plan.

PBGC. Pension Benefit Guaranty Corporation, the federal insurer of DB plans.

PPSEA. The Pension Preservation and Savings Expansion Act of 2003, H. R. 1776, major pension reform legislation proposed in 2003 by Representatives Rob Portman and Benjamin L. Cardin, the primary sponsors of EGTTRA.

Pre-tax contributions. Employee contributions to an employer-based 401(k) plan, 403(b) arrangement, 457(b) plan or to an IRA that are made from pre-tax income and are not taxed until they (plus earnings) are subsequently distributed from the plan.

Profit-sharing plan. A qualified plan that is a DC plan with a discretionary contribution formula.

Qualified plan. A DB or DC plan that satisfies the requirements of IRC § 401(a), and other relevant legal provisions. Under the special tax treatment available to qualified plans, employers may take an immediate deduction for contributions to their plans but plan participants are not taxed until they receive benefits from the plan.

Roth 401(k). A 401(k) plan funded with Roth contributions, rather than with pre-tax contributions, enacted in EGTTRA and scheduled to begin in 2006.

Roth IRA. An IRA funded through Roth contributions.

Roth contributions. A type of contribution to an IRA, created under IRC § 408A and named for former Senator William Roth, that is made from after-tax income and is generally not subject to tax thereafter. Beginning in 2006, 401(k) and 457(b) plans and 403(b) arrangements may permit Roth contributions.

RSA. Retirement Savings Account, proposed by the Administration in 2003 and 2004 as a uniform replacement plan for IRAs and Roth IRAs.

SARSEP. A form of SEP, established before 1997, permitting employees to make 401(k)-type contributions to their employer's SEP. A SARSEP is not a qualified plan.

SEP. Simplified Employee Pension Plan, a simplified employer-sponsored plan based upon IRAs created under IRC § 408(k). A SEP is not a qualified plan.

SIMPLE. Savings Match Incentive Plans for Employees, a simplified employer-based plan created under either IRC § 401(k) or IRC § 408(k) that has individual savings accounts to which both employers and employees contribute. A SIMPLE 401(k) is a qualified plan but a SIMPLE IRA is not.

Social Security integration. A safe-harbor exception to the nondiscrimination rules that permits employers to take Social Security into account when determining benefits or contributions in a qualified plan, as described in IRC § 401(l).

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Stock bonus plan. A qualified plan that is a DC plan with a discretionary contribution formula whose benefits are distributable in company stock.

Tax sheltered annuity. Another name for a 403(b) arrangement.

Thrift plan. A form of profit sharing plan that predates 401(k) plans and permits employee after-tax contributions.

Top-heavy rules. Tests found in IRC § 416 that requires qualified plans to provide minimum contributions or benefits if high-paid company officers and owners receive more than 60% of plan benefits or contributions.

Endnotes

1. The provisions of the Pension Preservation and Protection Act of 2003, H.R. 1776, can be found at: <http://thomas.loc.gov>, last accessed July 5, 2004.
2. Legislation to create Retirement Savings Accounts was introduced into the House of Representatives on June 25, 2004 as H.R. 4714, and legislation to create Lifetime Savings Accounts was introduced on March 31, 2004 into the House of Representatives as H.R. 4078 and the Senate as S. 2263.

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Chapter 6

The Future of Pension Plan Design

David McCarthy

Three decades ago, the Employee Retirement Income Security Act (ERISA) (1974) was passed, initiating a wave of change in US private pension provision. Since that time, many traditional private-sector defined benefit (DB) pension plans were replaced or augmented with newer defined contribution (DC) arrangements, including 401(k) plans. As the system matures, it is becoming increasingly clear that the problem of optimal pension scheme design has not yet been solved. The task ahead is to ensure that pension systems of the future are adapted to meet workers' retirement needs as well as employers' objectives, a task that will require substantial effort and focus.

In the past, it has been difficult to evaluate alternative pension scheme designs from an economic point of view. This is because there was no simple theory which clearly illustrated how firms and workers actually value their pensions: that is, real-world pension contracts were far more complex than those that could be modelled with economic tools. In recent years, however, the reduced cost of computing power has changed how analysts approach the problem. It is now possible to use numerical analysis to assess different pension plan designs using a coherent economic framework which is realistic enough to assist researchers and practitioners who study and design pension plans. In this chapter we develop a framework to design pension schemes and use it to present some illustrative results.

A key part of this framework is a model of employee preferences. A realistic model of preferences must include preferences for consumption and saving, the economic environment in which workers make their decisions (for instance, by including Social Security), the major risks to which individuals are exposed, and some assessment of changes in attitudes and exposures to risk¹ as people age. In this chapter, we argue that economic life cycle models are well suited for this purpose. Previous work has applied them successfully to examine saving and consumption patterns (Carroll 1997), lifetime investment allocation (Heaton and Lucas 2003), mortgage choice (Campbell and Cocco 2003), housing purchases (Cerny et al. 2004), and the impact of state pensions (Campbell et al. 2000), and of occupational pensions (McCarthy 2003). Here we show how life cycle models can be applied fruitfully to the issue of pension design, and,

further, how these models can be used to help design pension schemes which fulfil the objectives of both workers and firms.

In what follows we first identify factors that must be taken into account when designing pension schemes. Next we briefly discuss life cycle models of employee preferences and then present a specific model of this type. After sketching some results, we offer conclusions and draw implications.

Elements of Pension Plan Design

Economists recognize that pension plans are an element of employee compensation. This means that the efficiency of pension plan design can only be analyzed as a component of the efficiency of overall employee compensation. Several aspects of compensation contracts are key in this discussion, namely taxation, labor markets, employee preferences, and firm attitudes to risk. We also must acknowledge that the government is a third party to compensation contracts. That is, firms and workers can structure employment contracts so as to minimize tax revenues transferred to governments. In many countries, pensions are tax-advantaged over other forms of compensation such as cash. In the USA, for instance, pension contributions are not taxed as income in the hands of employees, and investment income on pension assets is shielded from tax. This gives employees one reason to favour pension compensation over cash compensation. Of course, tax needs to be paid on pensions when they are eventually drawn as income; Poterba (2004) examines the value of the pension tax shield from the point of view of US workers. From firms' viewpoint, pension contributions are similar to other forms of compensation such as cash, as both can be written off as an expense against taxation reducing the firm's taxation liabilities. Pensions are therefore a tax-efficient method of compensation from the point of view of employees.

We now turn to the role that pensions play in labor markets. In the simplest labor market, often called the 'spot' labor market, rational employees sell their labor services to firms each period on an open market. In this setting, there would be no involuntary unemployment and no internal labor markets in firms such as 'regular' pay scales, service-linked promotion, or retirement. Under this approach, and if employees had free access to capital markets, their firms would provide pensions in an employment arrangement only because of the tax advantage: providing for retirement via a company pension is cheaper than outside the firm. In other words, if pensions were not tax-favored, firms would not offer them to employees at all.²

Labor economists have developed several theories to explain why, in fact, pensions are offered as an element of labor contracts beyond the tax rationale. One prominent explanation is the deferred-wage theory, which holds that pensions can be used to induce long employee tenure at the firm.

This would be valued by firms where tenure is associated with higher worker productivity—perhaps because skills are specific to the job at hand and can only be learned on the job. Long tenure also reduces recruitment and direct training costs. Under this view, pensions are a way to pass some of the rewards of this extra productivity on to workers. The mechanism is thought to involve workers posting a ‘bond’ with the firm, by working for lower wages early in their employment. The deferred compensation is then returned to them in later years, in the form of a pension (or perhaps also with an upward sloping wage-tenure profile). Workers will consent to this arrangement if it pays them compensation which, in expectation, exceeds what they would earn without a pension (or with a flat wage-tenure profile). This increase compensates the fact that the worker must remain longer with the firm, and hence it has been called an ‘option loss’ or ‘indenture premium.’ DB pensions are thought to be especially useful for such backloaded employment contracts, since they explicitly defer pay until later in the contract and because they are harder for firms to renege on than unsecured promises. DC pensions with a vesting employer match may have similar effects.³

Another explanation offered by labor economists for pensions is that these contracts help manage the asymmetric information problem between the firm and potential workers, when firms are unable to verify the likely productivity of new hires. An employment contract which pays a pension defers payment to later in life, so jobs with pensions might be more attractive to workers who either have low discount rates, or who have greater expectations of salary increases, that is, those who expect to be more productive. Low discounters, it is believed, make better workers because they are willing to invest more in learning. As a result, offering a pension is likely to attract more productive workers, so this view is known as the ‘sorting theory’ of pensions.⁴

A related rationale for offering pensions is that firms which do can influence employee retirement patterns, an outcome of particular value to firms that use tilted wage profiles to control turnover (Fields and Mitchell 1982). This is because with tilted wage profiles, employees will earn more than their alternative opportunities before they retire, which is a disincentive to retire. Consequently, a firm can design its pension to induce workers to retire as part of the retirement contract. There are also sociological reasons why firms might wish workers to retire, including the transactions costs associated with forcing older employees with long service to retire if they are unable to fulfil their job responsibilities. Some types of pension are better at achieving these different goals than others: for instance, some pensions may have only a small effect on job turnover or sorting depending on how they are designed. The literature shows that DB pensions are especially effective at influencing retirement by means of nonactuarially neutral benefit formulas; by contrast, DC plans tend to be less influential of retirement outcomes, depending on the workers’ accumulated values as they near retirement.

All of the labor market explanations of pensions have one factor in common: they downplay the fact that employees are more risk-averse than firms, yet they can access the same capital markets as can firms. Workers are believed to be more risk-averse because investors who own the firms can diversify their exposure by trading in securities, while employees are unable to do the same with their wage income.⁵ Thus a financial economics approach to pensions would include the fact that different compensation arrangements can have very different implications for employees' portfolio costs in these plans. A further aspect of pensions to be considered in the financial economics context is the corporate finance aspect of pensions. That is, different pension strategies impose different risks on employers, which should be acknowledged in the modeling approach. For instance, DB pensions expose employers to investment risk and mortality risk. Also firms may have different risk preferences than their workers: for instance, a small family-owned business might react differently to risk than a public-sector employer. Some firms may also be able to hedge risks more easily: for instance, wage fluctuations might be reasonably well hedged by firm income in larger companies, while mortality risk would be very difficult for any firm but the government or a large life insurance company, to hedge effectively.

Another aspect of pension compensation which needs to be considered is the role that pensions play in workers' overall portfolios. Pension contracts change workers' risk exposures, and they also alter the allocation of compensation over the life cycle. For instance, DB pension arrangements magnify the risk exposure of an individual to salary risk, and both DC and DB pension arrangements defer the pay of younger workers to later in their lives. Younger workers might therefore value cash in hand highly, because they have immediate cash needs, while older workers might be more willing to defer compensation to later in life as they are saving anyway.

Both of these effects are portfolio costs that depend on how effectively employees can access capital markets on their own. To the extent that employees and employers can trade freely in capital markets, the portfolio efficiency of pension compensation is irrelevant, because well-informed employees will simply adjust their portfolios to achieve any desired risk exposure. By contrast, if employees cannot trade freely on capital markets—for instance because of portfolio restrictions, liquidity constraints, moral hazard or incomplete markets—then the portfolio efficiency of pensions becomes important. An example might make this clearer. For instance, imagine that employees were offered movie tickets as part of their compensation package. Two movie tickets per month might be an effective way of compensating employees who like to go to the movies. But if employees were paid a large fraction of their wages in movie tickets, the value they place on this compensation would decline dramatically because they cannot cheaply sell large numbers of movie tickets for cash. By choosing to pay

employees in movie tickets, the firm imposes on workers a portfolio cost. We might therefore call this form of compensation portfolio inefficient, in this case entirely because of the transactions costs involved in regularly selling large quantities of movie tickets.

In some respects, paying individuals pensions is akin to paying them movie tickets: pensions cannot be traded or borrowed against, and they impose liquidity constraints on workers. Pensions also increase worker exposure to risks which cannot be traded, such as wage risks. Unlike movie tickets, of course, pensions produce income in retirement and may also protect workers from some risks.

A general framework for deciding optimal pension design should take account of all four of these aspects: tax efficiency, incentive compatibility, portfolio efficiency, and corporate finance. Yet only a partial list has been considered in previous studies. For instance, Ippolito (1994) assessed compensation strategies which account for some labor incentive aspects, but he ignores worker portfolios. Bodie et al. (1988) examine pensions from the point of view of portfolio efficiency, but they ignore labor market aspects, taxation, and corporate finance issues. McCarthy (2003) has a more complete model of portfolio efficiency and mentions firm risk, but he assumes that firms can hedge all their pension risks away.

A Model of Pension System Design

We have argued that a comprehensive framework for a theoretically optimal pension compensation strategy would recognize the key role of the following elements:

1. A *firm* which chooses a compensation strategy (i.e. designs a pension plan) based on some criterion, for instance, maximizing expected profits. Risk-averse smaller firms might take some of the risk they are exposed to by pension arrangements into account, too, in determining the optimal pension.
2. Workers who respond to the *incentives* provided by compensation strategies. Pension design affects firm profits via the direct cost of the compensation, and also via the effect that compensation has on worker recruitment and behaviour. This would include labor market aspects such as sorting, tenure and retirement.
3. An *incentive compatibility constraint* to ensure that the pension does not cause worker and firm incentives to be misaligned; and
4. A worker *participation constraint*, which ensures that the firm is able to recruit the quality and quantity of workers it needs to produce its output. To take into account worker preferences, this would need to be expressed not in terms of the wages that the worker is offered, but in terms of the lifetime utility that the worker expects to achieve. This

measure takes into account the portfolio efficiency of the pension scheme within the context of the worker's entire portfolio. This portfolio includes worker's future wages, the major risks to which the workers are exposed (investment risks, mortality risk, income risk), the preferences of the worker, any portfolio restrictions on the worker, and how all of these factors change over working life and retirement.

These ideas may be illustrated using a simple three-period model of employment and pensions, building on Ippolito (1994) who examined indenture premia, and Bodie et al. (1988) who assessed the portfolio effects of different pension arrangements. Here we posit two work periods and one retirement period. Employers may pay remuneration during the retirement period which is the pension. Workers have access to capital markets but they can only save, not borrow against future wages. There is only one asset and it is not risky. Workers have no assets except what they have saved and their future wages, called here their human capital. Workers must save to smooth out consumption over their lifetimes. In this simple formulation, there is no Social Security system and compensation including only wages and (possibly) pensions. We further abstract from taxes and uncertain mortality. For simplicity, the interest rate on the risk free asset and workers' discount rates are assumed to equal zero. The model also assumes that per period hours of work are fixed and that the firm faces an infinite demand for goods at the current price.

The firm can choose a wage profile w_1 and \tilde{w}_2 , and a pension \tilde{p} . At the beginning of period 1, the employee knows w_1 but not \tilde{w}_2 or \tilde{p} . The values of these are revealed at the beginning of period 2 and may be random. However, the worker knows the statistical distribution of likely second-period wages and pension payments. Then, given a compensation structure, the employee chooses his consumption in periods 1 and 2 to maximize:

$$U(w_1, w_2, \tilde{p}) = \max_{c_1, c_2} u(c_1) + E[u(c_2) + u(c_3)]$$

$$\text{s.t. } 0 < c_1 \leq w_1, 0 < c_2 \leq w_1 - c_1 + \tilde{w}_2 \text{ and } 0 < c_3$$

$$= w_1 - c_1 + \tilde{w}_2 - c_2 + \tilde{p}.$$

The constraints come from the fact that the employee is assumed to start off with no assets and cannot borrow against future income. In the final period, the worker consumes all his assets. This is a particularly simple model of preferences: in principle, it could be made as complex as desired.

Let the pension \tilde{p} be a final salary DB pension with accrual rate α . Contributions to the pension are deducted from cash wages, and because the interest rate is zero, expected contributions must sum to the expected pension. If we assume that $E[w_2] = w_1$ and that $\tilde{p} = 2\alpha w_2$, for $\alpha \geq 0$, and that the employer is risk-neutral, then the employer's optimization problem is:

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$$(w_1, w_2, \alpha) = \arg \max_{w_1, w_2, \alpha} R(w_1, w_2, \alpha) - w_1 - w_2 E[\tilde{Z} + 2\alpha\tilde{Z}]$$
$$\text{s.t. } U(w_1, w_2, \alpha) \geq \bar{U} \text{ and } \alpha, w_1, w_2 \geq 0$$

Here the term $R(w_1, w_2, \alpha)$ represents the revenue the firm earns from selling its products, net of training and recruitment costs. If the compensation structure makes workers work harder, then net revenue will be higher, which is why revenue is a function of the compensation structure.

The participation constraint $U(w_1, w_2, \alpha) \geq \bar{U}$ shows that employers design a compensation contract which attracts workers. In this model there is no incentive compatibility constraint: this could be introduced by stipulating that in all periods, workers may not sell future labor for current wages.

The implications of this simple model are interesting. First, firms have an incentive to pay workers in ways which are beneficial for the worker. It is not necessary for firms to 'care' about workers for this to be so: by paying employees in a form the employees value, employers reduce their total compensation bills and potentially increase profits. Alternatively, by paying workers in a form they do not value, firms increase their total compensation bill and therefore earn fewer profits. A familiar example of this phenomenon involves taxation. Arguably, in the USA, firms are fairly indifferent between 401(k) pension and cash compensation from a tax point of view: both can be written off against income to reduce the firm's tax liability.⁶ However, because workers face a lower tax bill on pension compensation, firms can give workers a higher post-tax wage by paying part of the wage as a pension. A less familiar example might be the form of the benefit itself: if workers are paid a risky pension which they cannot hedge, as in the above example, firms must boost wages to compensate employees for taking on this risk.

If we introduce into the above analysis risks that workers and firms can hedge by trading on capital markets, some perhaps surprising results obtain. For instance, firms derive no value from protecting workers from risks that workers can hedge, such as investment risk, and they will get no benefit from exposing workers to these risks. The reason for this is that workers could choose to buy this protection on the markets themselves, and they would pay the same price as the firm. In this setting, employees are indifferent between receiving protection from traded risks as part of their compensation (which they could then sell for cash if they wished), or receiving cash and buying the protection themselves. Of course, in the real world, workers cannot trade freely on capital markets for many reasons, one of which is the cost of learning how to manage assets. Yet this model suggests that the cost of prescribing an investment strategy for workers in their pension plans is relatively low, if workers are able to trade competently themselves. If workers are unable to trade competently, the benefits of prescribing an investment strategy may be quite high.

Two other implications of this analysis need to be mentioned. The first is the issue of underfunded DB pension plans. If promising workers a stake in an underfunded pension plan has no effect on effort, then this is an expensive way to pay workers. This is because workers already have substantial undiversifiable exposure to the firm: if the firm goes bankrupt, they stand to lose their jobs. Giving workers a claim on an underfunded pension is paying them partly with long-term credit notes on the company, which boosts their exposure to the firm's credit risk. If the firm is a publicly traded corporation, workers could hedge this risk by selling the company stock short, or by buying credit default swaps on the firm's debt instruments (assuming these can be purchased). Of course there may be incentive problems caused by the workers effectively holding a short position in the company stock, and workers will suffer transactions costs and will need to be reimbursed for these in the form of higher total compensation. The firm could thus reduce compensation costs by paying workers with a fully funded pension. If the firm is not publicly traded, then workers have no way of diversifying this risk away and will have to be compensated for the credit risk of the firm in the form of higher total wages. Paying workers in the form of insecure, underfunded pensions is therefore an expensive way to compensate them.

A second issue is compensating workers with 401(k) plans that contain restricted company stock. Exactly the same theoretical analysis as performed above applies: in the absence of incentive effects, this is an expensive way for firms to remunerate employees because they are already heavily exposed to company risk. Watson Wyatt (2004) reports the results of a US survey showing that workers routinely value options and restricted stock at a discount to their true cost. It is interesting that some employers say they pay employees in this form because they believe that it will help to align the incentives of workers and owners, partly to induce workers to sort themselves, and partly to retain workers.⁷

More Realistic Pension Designs

Next we turn to a life cycle model which extends the framework above, by using a computational approach that permits an evaluation of how workers might value pensions of different types, and how one might develop optimal pension compensation strategies for employers, under a range of economic and demographic assumptions. We build on McCarthy's (2003) life cycle model to characterize the major risks to which workers are exposed (investment risks, wage risks, and mortality risk), and how the workers exposure to these, changes as they age, retire, and finally die. In this approach, the worker is assumed to maximize utility and work until age 65 when he retires; death happens with certainty before age 100 but he might also die before retirement. (In practice, we use mortality patterns of

US females born in 1980.) Each period he works, he receives a risky wage which may be consumed or invested in stocks or bonds, with the asset allocation redetermined each year. The bond pays a constant real rate of return, while stocks pay a risky rate of return. The worker cannot borrow against future wages or stock holdings, and he cannot sell stocks short in order to buy bonds. To keep the analysis tractable, we abstract from a Social Security system and housing assets in this model. The structure of the model is outlined in Table 6-1.

To represent real-world earnings data, we assume that wages are subject to transitory and persistent shocks. The transitory shocks affect only current earnings and have no effect on future pay (e.g. a sales agent might have a bad week because she had a cold), while persistent shocks are

TABLE 6-1 Structure of the Life Cycle Model

	<i>Working period</i>				<i>Retirement period</i>		
Time	<i>I</i>	<i>2</i>	...	<i>T</i>	<i>t + 1</i>	...	<i>t + s</i>
Income	W_1	W_2	...	W_t	0	...	0
Wealth	A_1	A_2	...	A_t	A_{t+1}	...	A_{t+s}
Pension	P_1	P_2	...	P_t	P_{t+1}	...	P_{t+s}
Consumption	C_1	C_2	...	C_t	C_{t+1}	...	C_{t+s}
Risky asset return		R_2	...	R_t	R_{t+1}	...	R_{t+s}

Notes: At each time period the individual chooses how much to consume and how much to save from current income. The asset mix of savings (between bonds and equities) can be adjusted each period. Income is stochastic with permanent and temporary errors. Risky asset returns are assumed to be log normally distributed with a constant mean and variance. Retirement is assumed to be at age 65. The individual is assumed to face mortality while working and retired. The maximum possible length of the retirement period is 35 years. At time 0, the individual is offered a pension contract, which may be a defined benefit (DB) or a defined contribution (DC) pension. At retirement, the individual can choose to purchase an annuity from private savings on the private market. To model the costs of adverse selection, the annuity is not priced fairly but has a multiplicative loading factor incorporated into the price. This annuity pays a level annual pension for life. The individual can purchase an annuity regardless of the pension plan arrangement. Annuities that are mandatory do not attract an adverse selection charge; voluntarily-purchased annuities attract a charge for adverse selection. There is no bequest motive, labor supply is assumed to be exogenous and the individual is not permitted to borrow either stocks or bonds. The individual maximizes:

$$\max_{\{Y, C_i, \alpha_i\}} E_0 \sum_{i=1}^{t+s} \beta^i \pi_i u(C_i)$$

where

$$u(C) = \frac{C^{1-\gamma}}{1-\gamma}, \quad \gamma \geq 1,$$

and π_i is the assumed probability the individual is alive at time i conditional on being alive at time 0. The individual is offered one of several pension arrangements as described in the text.

assumed to influence future wages (e.g. a professional skier might have a serious accident). Such shocks cause wages to fluctuate around age and education-dependent wage profiles derived from US data (see the notes to Table 6-1). Workers with different educational backgrounds are permitted to have different mean earnings as well as different earnings shocks. The data also show that more educated workers tend to have more permanent wage shocks, a fact with important implications for pension design.

Just after retirement, at age 65, we assume that the retiree can buy an annuity in the private annuity market at an actuarially unfair price—which means that the expected present value of the lifetime benefit is below the annuity premium. The price is set to be unfair to reflect the possibility of adverse selection in the annuity market. During the retirement period, the retiree then receives income equal to any pension plan income, plus his private annuity income. The individual is assumed to choose his consumption, investment strategy, and annuitization to maximize his expected discounted lifetime utility. Using numerical techniques discussed in McCarthy (2003), we calculate the total expected discounted lifetime utility workers of different ages and types. By calibrating the parameters of the model to actual US data, we can use the model to approximate preference structure of US workers. This allows us to examine how these workers might value pensions of different types.

To implement the model, we must further specify tastes for consumption in each period, the worker's degree of risk aversion (which affects how much he would willingly pay for insurance against risk), and his personal discount factor (the higher the discount factor, the more valuable is consumption today versus tomorrow). We denote the expected discounted lifetime utility of the worker with no pension benefit as $U_0(1)$; the lifetime utility of a worker with no pension benefit but having an initial endowment and lifetime income is higher by a factor of m , so his utility may be written $U_0(m)$. To introduce different pension arrangements into the model, we let the lifetime utility of a worker with a pension of type i be denoted by $U_i(1)$. More details appear in Table 6-2.

The specific pension arrangements to be examined here include the following:⁸

1. *A noncontributory DB pension with varying replacement rates.* This pension pays a benefit from retirement (age 65) until the individual dies, with the benefit set to equal a fraction α of the individual's final salary (hence α is the pension replacement rate). We define the worker's expected discounted lifetime utility with this pension benefit as $U_1(1)$, and the expected discounted cost of this benefit to the employer is C_1 .
2. *A DC pension with contributions over and above cash wages of 10 percent of pay; here there is no investment choice and no mandatory annuitization.*

TABLE 6-2 Model Parameterization

	<i>Assumption^a</i>		
Risk aversion	5		
Time preference	4%		
Risk-free interest rate	2%		
Equity risk premium	4%		
Equity uncertainty	$\sigma_{\eta} = 0.157$		
Permanent income profile	Polynomial profile ^b		
Income uncertainty	$\theta = 1$	$\theta = 1$	$\theta = 1$
	$\sigma_{\xi} = 0.130$	$\sigma_{\xi} = 0.136$	$\sigma_{\xi} = 0.162$
	$\sigma_{\varepsilon} = 0.121^c$	$\sigma_{\varepsilon} = 0.103^c$	$\sigma_{\varepsilon} = 0.102^c$
	(College)	(High School)	(No High School)
Mortality		US Females ^d	
Equity/permanent wage error correlation	$\rho_{\eta\xi} = 0.15$	$\rho_{\eta\xi} = 0.10$	$\rho_{\eta\xi} = 0.10$
Liquidity constraints	Imposed		
Private annuity market	$\lambda = 10\%^c$		

Notes

^a No bequest motive is assumed and labor supply is assumed exogenous.

^b This profile, from Campbell et al. (2000), was estimated from the Panel Study on Income Dynamics (PSIS) separately for college-educated individuals.

^c These estimates are from Campbell et al. (1999) PSID analysis; his temporary standard deviations for college-educated individuals were halved to allow for measurement error. These values are slightly higher than those found in Hubbard et al. (1995), Heaton and Lucas (2000), and Carroll (1996).

^d We use projected mortality for the 1980 cohort of US females calculated by the Berkeley mortality database with data from the Social Security Administration; see demog.berkeley.edu/wilmoth/mortality

^e Mitchell et al. (1999) estimate adverse selection and loading costs to be around 10 percent of the cost of annuities.

Under this plan, contributions accumulate in a separate account which the worker will not be permitted to access before retirement. At retirement, the DC assets are added to the retiree's other assets and these may be used in whole or in part to buy a private annuity, or they could be consumed freely. We denote the expected discounted lifetime utility of the worker with this pension benefit as $U_2(1)$, and the employer's expected discounted cost of this benefit as C_2 .

3. A DC pension with contributions over and above cash wages of 10 percent of pay; here there is no investment choice but annuitization is mandatory. In this case, the contributions accumulate in a separate account as before, but after retirement the worker receives a lifelong annual pension payment equal to the accumulated DC balance at retirement, divided by the price of a fair annuity. We denote the expected discounted

lifetime utility of the worker with this pension benefit $U_3(1)$, and the employer's expected discounted cost of this benefit as C_3 .

To calculate the value of the different pension arrangements to the individual we solve for m_i in the following equation: $U_0(m_i) = U_i(1)$. In economic terms, m_i is the 'compensating variation' if pension arrangements change. It is the factor by which a worker's initial endowment and lifetime income would have to be changed, in order to exactly compensate him for the change in that pension. If m_i is high, we can conclude that this particular pension is more highly valued than when m_i is low. We solve this equation by noting that, from the preference function assumed, a change in m is nothing more than a change of currency or numeraire, and therefore that:⁹

$$m_i = \left[\frac{U_i(1)}{U_0(1)} \right]^{\frac{1}{1-\gamma}}$$

It should be noted here that this specification only focuses on employee preferences: there is no explicit employer in this model so it includes only part of the more complete framework discussed previously.

Results

To make the different pension arrangements comparable, the results in Table 6-3 constrain the costs of each pension offer to the same proportion of workers' lifetime cash wages (this version of the model abstracts from taxes). These results have implications of offering an employee different pension schemes, each of which has the same cost. The cost for each DC arrangement is therefore set at 10 percent of lifetime income from the point that the worker joins the plan onward. The DB plan generosity is adjusted at each age to ensure that its cost is equal to that of the DC arrangement. For instance, for a worker with no high school education who joined the DB plan at age 30, a contribution of 10 percent of cash wages until retirement was sufficient to purchase a DB pension with a replacement rate of 40 percent; by contrast, for a worker with no high school education joining the plan at age 50, this contribution would only be sufficient to purchase a pension with a replacement rate of 12 percent. The generosity of the DB pension declines in a nonlinear way with the age at joining, because of the effect of earnings, mortality, and interest rates over the life cycle. Workers with different educational backgrounds who pay contributions worth 10 percent of wages into a DB pension plan will end up with pensions of slightly different generosity, because of different expected wage profiles.

A key variable of interest in the pension design arena is the difference between the cost of the pension, paid by the firm in this model, and the

TABLE 6-3 Pension Value Minus Pension Cost (Welfare Loss) Under Various Plans, as a Percentage of Pension Cost

	Age 30			Age 40			Age 50		
	College	High School	No High School	College	High School	No High School	College	High School	No High School
Model 1: DB plan	39 (38)	27 (37)	26 (40)	22 (25)	14 (24)	12 (25)	8.7 (13)	1.3 (12)	2 (12)
Model 2: DC plan									
30% equities	5	8	15	10	7	8	7	12	14
70% equities	10	12	18	12	7	10	7	12	14
100% equities	15	16	22	14	9	12	8	12	15
Model 3: DC plan									
30% equities	12	17	21	19	15	7	6	11	14
70% equities	16	18	24	19	15	8	6	10	13
100% equities	22	24	28	22	16	9	6	10	13

Notes: The table shows the value of $(10\% - m_i)/10\%$, where m_i is the increase in lifetime cash wages required to compensate the worker for the loss of the pension arrangement described. The value m_i solves the equation:

$$m_i = \left[\frac{U_i(1)}{U_0(1)} \right]^{\frac{1}{1-\gamma}}$$

where $U_0(m_i)$ is the expected discounted lifetime utility of an individual with no pension (see Table 1), and $U_i(m_i)$ is the expected discounted lifetime utility of the same individual but with the pension arrangement described in the first column of Table 3. Model 1 is a DB final salary pension that pays a life annuity with a replacement rate shown in brackets, multiplied by the worker's final annual salary. The cost of each DB pension is 10 percent of lifetime income from that age until retirement. Model 2 is a mandatory DC scheme with contributions equal to 10 percent of earnings and with an investment mix as shown (the first number refers to equities), but with no mandatory annuitization. Model 3 has the same DC scheme but requires mandatory annuitization. The DC figures are evaluated with temporary wage fluctuations turned off. All figures assume non-pension wealth in the first year (e.g. age 30, 40 or 50) equal to expected wages in that year.

cash-equivalent value of the pension, which is the compensating variation to the worker. If a worker felt that the cash equivalent of a pension was worth less than the cost of the pension to the firm, then that pension would be an inefficient way to pay people (or the difference would have to be due to some other aspect not in the model, such as tax efficiencies or labor market effects of the pension on sorting and turnover). Table 6-3 shows the difference between the cost of the pension (assumed at 10 percent of cash wages for all pension types), and the compensating variation of the pension; the gap is then expressed as a percentage of the cost of the pension.¹⁰

One striking result in Table 6-3 is that all the values are positive: that is, the compensating variation of pensions is always less than the cost of the pension. This is because, in the absence of tax effects, workers are always better off with cash than with pensions because of the undiversifiable risks to which pensions expose them, and because of the forced savings aspects and illiquidity of pensions. Consider a worker age 30: in the DB plan, the figures in parentheses show the pension replacement rates that could be purchased by contributions worth 10 percent of cash wages. For a college-educated 30 year old, 10 percent of lifetime cash wages will purchase a DB pension with a replacement rate of 38 percent. But the table shows that this worker would receive equal lifetime utility from a boost in cash compensation worth 39 percent *less* than the pension plan's cost. In other words, unless the labor market and taxation effects of paying a DB pension are worth 39 percent of the pension cost, it is an expensive proposition to pay the worker such a DB pension. Workers of the same age but with less education value a DB plan only slightly more: the welfare loss is 27 percent of the cost of the pension for those with a high school education, and 26 percent for those with no high school education.

It is of interest that, under Model 2, the loss from a DC plan is lower than for a DB plan for some individuals but not others, such that college-educated individuals have a lower loss (15 percent for a plan invested all in equities) than the less educated (22 percent for the same portfolio). It is also worth noting that the value of a DB plan is relatively higher for low-educated workers than for highly educated, particularly for those entering the firm at older ages. We also find that mandatory annuitization under the DC plan reduces the welfare loss of DC pension arrangements by roughly 7 percent, comparing Model 2 with the voluntary annuitization results for Model 3. This result may overstate the appeal of annuitization to the extent that other alternatives are available (cf. Yaari 1965).

The impact of mandatory investment policy in the DC plan on welfare losses is much smaller than some may have anticipated: for instance, the welfare loss grows by only about 10 percent of the pension cost, when the investment strategy changes from 30 percent to 100 percent equities. The reason is that the investment strategy is only important while workers are liquidity-constrained. Once they have amassed sufficient assets outside

the pension plan, they can alter the investment mix of those other assets to achieve any desired overall asset allocation.

We now examine the results for a worker aged 40, with 25 years until retirement. Here the DB pension plan imparts a lower welfare loss than before, because wage uncertainty for older workers is lower due to the fact that fewer years remain until retirement. In addition, because they are nearer to retirement, the liquidity constraint associated with forced saving in pensions is not as binding because these workers are starting to anticipate retirement and increase their savings. The DB plan is still less favorable for college-educated workers than for other types of workers, for the reasons discussed. For DC pensions, the welfare loss is smaller for older workers because the natural propensity to save of workers increases with age. Therefore the forced savings aspect of DC pensions is smaller, and the illiquidity of the DC pension wealth is less of a factor. In addition, the DC investment strategy has a much smaller effect on wellbeing, because of the fact that with higher savings, the range of achievable overall investment strategies is greater despite the pension investment restrictions. Differences between subjective valuations of the DC pension by different classes of worker are surprisingly large. This may be due to the different age-wage profiles of the different classes of worker or the different pattern for wage shock variance and persistence.

By age 50, the welfare loss associated with the DB plan is less than that associated with the DC plan, for low-educated workers. This is due to the effect of declining human capital and increasing financial capital on the valuation of DB pension plans, as discussed above. The welfare loss of DC pension falls due to the fact that most workers at age 50 are saving for their retirement which looms near, at age 65. There is now almost no difference between the welfare losses of DC pensions with very different investment strategies, as most individuals are saving enough to ensure that they are able to achieve their optimal desired overall asset allocation. Once again, there are surprisingly large differences between workers of different types.

Implications and Conclusions

Though many forms of pensions have been tried in the marketplace to date, it is fair to say that the pension environment is in flux around the world. Much work remains to design pension systems that best meet employee needs as well as employer objectives. This chapter draws together the literature on pension compensation and optimal portfolio choice to seek solutions to the 'pension design' problem.

Inasmuch as pension schemes are an element of employee compensation, we propose that pension design must be evaluated in terms of how well any given plan format fits into the objectives set for employee compensation more generally. Our financial economics approach to pension

design recognizes the fact that compensation arrangements can have very distinct impacts on employees covered by these plans. In particular, pension contracts alter workers' risk exposures and the allocation of compensation over the life cycle. As a result, having a pension, changes the value that an employee would ascribe to different pension and compensation arrangements.

Our results suggest that DB pension arrangements magnify the risk exposure of an individual to salary risk, and both DC and DB pension arrangement defer the pay of younger workers to later in their lives. Younger workers therefore value cash more highly, and DC plans in particular, because they have immediate cash needs. In contrast, DB pensions may be a cost-effective method of compensation for older, less well-educated employees. We also conclude that promising workers a stake in an underfunded pension plan is an expensive way to pay employees, particularly if the underfunding has no positive impact on effort. Of course, giving workers 401(k) plans holding restricted company stock is also an expensive way to remunerate employees, because they are already heavily exposed to company risk.

Our results also imply that a hybrid scheme might be designed to better suit both types of employees. Such a plan would have workers beginning their careers with a DC pension heavily invested in bonds, and then later they would switch to a fully-funded DB scheme; this would likely be a cost-effective way of remunerating employees. Several factors which have not yet been incorporated in our model strengthen this conclusion. The first has to do with job turnover, which makes DB plans riskier for younger employees because of the fact that most vested DB pensions in the US are not indexed to inflation after workers terminate. This exposes individuals to inflation risk in their DB pensions and imposes a pension capital loss on these workers. Awareness of such risk would further reduce the attractiveness of DB plans for younger employees.¹⁰ Also if employees find it is costly to make pension investment decisions, having the employer select a DC investment strategy would benefit the employees while imposing few costs on those workers able to adjust their own portfolios to compensate for the imposed pension investment mix. An alternative design might be a form of fully matched cash balance plan for younger workers, which changes to an explicit salary link for older workers.

We must note that our model here does not include taxes, which prevents us from inferring the overall level of pension generosity relative to cash wages. Poterba (2004) computes the value of the current tax shield accorded to US retirement accounts, and he finds that in the case of fixed-income assets, the tax shield is not very large unless very long time horizons are used (and even then only for workers with high marginal tax rates and high interest rates). For equity investments, the tax protection of pensions is significantly lower in all cases. While the tax effects might have been

larger in the past, currently the tax effects appear small, implying that the labor market effects of pensions—and especially DB pensions—would have to be substantial, to justify their use as a compensation tool for younger workers.

Future work will extend our analysis of optimal pension design. We anticipate including worker preferences more explicitly within this framework to derive optimal pension compensation strategies for workers of different types, who are engaged at firms having varying attitudes toward risk. A further area needing more work in the financial economics context is the corporate finance aspect of pensions. That is, different pension strategies impose different risks on employers, which should be acknowledged in the modeling approach. We also expect to evaluate the sensitivity of results to assumptions regarding worker responses to pension incentives, and we hope to test model predictions using firm-level pension data.

Endnotes

1. This is a simple model of the labor market which ignores issues such as transactions costs, skills specificity, on-the-job training, customs, indenture premia, differences in risk aversion between firms and employees, asymmetric information and incentives, all of which may have implications for pensions. Bulow (1982) presents an early discussion of labor markets and pensions from a financial point of view.
2. Lazear (1979) discussion of wage-tilt and tenure, and Ippolito (1997) covers the compensation aspects of DC pensions.
3. Allen et al. (1993) and Ippolito (1997) discuss pensions and sorting.
4. Of course, some firms may be more risk averse than others: for instance, the attitude to risk of a small family-owned business is likely to be very different to that of a publicly traded multinational company.
5. This abstracts from the fact that 401(k) contributions are subject to social security payroll tax.
6. See Oyer and Schaefer (2004) for an empirical investigation of why employers pay employees with stock options.
7. Euler equations are derived in McCarthy (2003).
8. The model was checked by solving the same equation numerically, and the results were found to agree with the analytical results to the degree of precision reported in the tables.
9. It should be noted that further assumptions are required to interpret the results as speaking to the efficiency of different pension formats. If pensions have no labor market effects, and the firm is risk neutral or can hedge all pension-related risks (such as wage changes and mortality changes) perfectly, then the results may be interpreted as informative about the efficiency of pension compensation from the firm's point of view. The results can also be used to assess how large the labor market effects of pensions need to be, to make them an efficient compensation strategy.

10. Of course, if the presence of a DB pension plan had significant effects on the turnover of younger employees, this higher cost might be offset by lower recruitment and training costs.

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Chapter 12

Profitable Prudence: The Case for Public Employer Defined Benefit Plans

Gary W. Anderson and Keith Brainard

US public sector plans covering employees of state and local governments have grown to comprise a substantial segment of national pension assets and membership. Participants include more than 14 million workers—10 percent of the national workforce—and six million retirees as well as other annuitants; all are members of more than 2,000 retirement systems sponsored by a state or local government (US Census 2002). These systems have combined assets of more than \$2 trillion and they distributed over \$110 billion in pension and other benefits (Board of Governors 2004; US Census 2002); this volume exceeded the entire economic output of twenty-two states and the District of Columbia (US Dept. of Commerce 2003).

In recent years, public sector pensions have diverged from the private sector pension trend, in that the percentage of public employees participating in a defined benefit (DB) plan has held steady at around 90 percent, while the fraction of private sector workers with a DB plan has plummeted to around 20 percent (BLS 2002). Against the backdrop of thirty years of private pension experience with the Employee Retirement Income Security Act (ERISA) of 1974, it is useful to note that US public sector pensions evolved before, and outside the purview of, this federal legislation. This different experience makes it invaluable to not only learn what effects state and local government pensions have on stakeholders—including participants, public sectors employers, and taxpayers—but also to glean lessons that the public pension experience may offer to private industry.

A Brief History of Public Pensions

Public DB plans have engaged in substantial efforts to reinvent themselves in recent years, adding elements that increase their flexibility and portability. Nevertheless, public plans retain the core attributes of a traditional DB model: that is, the employer bears investment risk and the plan pays lifelong benefits according to a specified formula. Against this backdrop,

it remains the case that each of the over 2,000 public retirement systems has its own unique plan design, benefit structure, and governance arrangement, set forth in a vast assortment of state constitutions, laws, and administrative rules. This mosaic of structures and features reflects each state's rich variety of legal, political, economic, and demographic cultures and history, as well as its political subdivisions. In other words, state and local government plans are creatures of state constitutional, statutory, and case law. As such, public pensions are accountable to each state's legislative and executive branches, independent boards of trustees which often include employee representatives and ex officio publicly elected officials, and ultimately, the taxpayers of that jurisdiction.

Although some US public pensions date to the late Nineteenth century, most public plans were established between the 1920s and 1940s. These were mainly of the DB variety. Municipal governments led states and the federal government in providing pension coverage for their workers, largely because the first groups to be covered—police, firefighters, and teachers—were established at the local level, by cities, towns, and school districts. As Clark et al. (2003) point out, these plans were initially financed from employee contributions, as a form of 'forced saving plans,' although over time, employers gradually took on greater responsibility for plan financing.

Because public employees initially had their own plans, the US Social Security system initially excluded state and local government workers due to uncertainty about whether the federal government could legally tax state and local employers. In 1950, Congress amended the Social Security Act to allow states to voluntarily provide Social Security coverage for their employees, if the state entered into an agreement with the Social Security Administration (Mitchell and Husted 2001). Today, the majority of state and local government employees participate in Social Security; the remaining nonparticipants are teachers and public safety personnel though most public employees in seven states do not participate (Alaska, Colorado, Maine, Massachusetts, Louisiana, Nevada, and Ohio). Where employees are exempt from social security contributions, the pension benefit and contribution levels are typically higher.

The passage of ERISA and subsequent amendments were watershed events in the evolution of private industry pensions, but these had little impact on public pensions which remained largely untouched by federal regulation. As Metz noted (1988: 4):

Governmental plans are specifically exempt from all of the substantive qualification requirements added to the (Internal Revenue) Code by Title II of ERISA (with the exception of the Section 415 maximum limitation on benefits), including those relating directly to participation, vesting, funding, prohibited transactions, joint and survivor annuities, plan merger and consolidation, alienation and

assignment of plan benefits, payment of benefits, certain social security benefit increases, and withdrawal of employee contributions. In addition, governmental plans are exempt from ERISA's other major provisions, including reporting and disclosure requirements (Title I) and plan termination insurance (Title IV). Although governmental plans are not subject to ERISA's participation, vesting, funding and fiduciary rules, they are, nonetheless, covered by comparable although not as restrictive rules as stated in the Internal Revenue Code before ERISA's enactment.

In the private sector, ERISA's impact was to impose a relatively uniform and comprehensive set of regulations and standards to the pension sector; by contrast, public retirement systems' diverse nature would not be possible if they had been governed in a like manner. This is not to say that the federal government has not tried, as noted by the GFOA (1992):

Since passage of ERISA, in 1974... Congress has deliberated over federal involvement in the setting of conforming standards for state and local government retirement systems. In 1978, the Pension Task Force Report, issued by the House Committee on Education and Labor, recommended federal regulation of PERS. Legislative proposals have been introduced in each successive Congress to establish federal rules for state and local government retirement systems. However, during this period PERS have made great strides in funding future pension obligations, following prudent investment policies, disseminating information and implementing administrative and operational discipline. These advances have been made without the intervention of the federal government.

Public versus Private Sector Plan Differences

Since the passage of ERISA, the percentage of private sector workers with a DB plan as their primary retirement benefit has fallen steadily, while coverage has risen by defined contribution (DC) plans (primarily of the 401(k) variety). A recent Bureau of Labor Statistics (BLS 2003) study found that only 58 percent of full-time private sector workers participated in an employer-sponsored retirement plan, and only 10 percent of private sector employers nationwide provided a DB plan. By contrast, virtually all full-time public sector employees participate in a retirement plan, and the vast majority (90 percent) is in a DB plan. Here benefits are usually expressed as a percentage of salary for a designated period just before retirement, multiplied by years of service credit (Findlay 1997).

What accounts for the divergence in pension coverage and type, when comparing private industry and the public sector? Several reasons have been offered for the loss of ground by DB plans in the private sector: increased private-sector government regulation; changes in the private-sector workplace, including growing employee and employer appreciation of DC plans; changes in business awareness regarding risk associated with funding DB plans; falling firm size; greater global competition boosting the

need for more flexibility in plan design; and successful marketing efforts of consultants and DC plan service providers (Rajnes 2002).

Nevertheless, there are also less appealing consequences of relying on DC plans as the primary retirement benefit (CBO 2003). For instance, DC plans are seen as an unreliable vehicle for ensuring financial security in retirement to the extent that investment risk is borne solely by individual participants; this is exacerbated when plan participants are poor investors. A study prepared for the Nebraska Public Employee Retirement System (PERS) found that from 1983–99, that system's DB plans generated an average of 11 percent annually, but the system's DC participants paid returns of only 6 percent (Buck Consultants 2000). This occurred despite ongoing efforts by the PERS to educate participants on the importance of proper asset allocation. Nebraska PERS also found that a large percentage of terminating DC participants cashed out their retirement saving rather than retaining them in a retirement account. One explanation for why public DC plan returns lag professionally invested DB portfolios is that the DC asset allocations are often quite conservative. For instance, approximately half of all assets held in 403(b) and 457 plans (primarily and exclusively used by public employees, respectively) were held in the form of annuity reserves at life insurance companies (ICI 2004).

Another concern with DC plans as the primary retirement benefit is termed the 'leakage' problem, a term applied to describe a variety of circumstances when retirement assets are spent by plan participants before retirement. For example, leakage occurs if an employee chooses to spend his retirement assets after leaving a job, rather than rolling them over to an Individual Retirement Account or to a new employer's retirement plan. Leakage also occurs when workers borrow against their retirement plan assets and then fail to repay the loans. A recent study by Brainard (2003:7) addressed the issue of leakage as follows:

A good example of terminating participants spending, rather than saving, their retirement assets are in Nebraska, where state and county government employees historically have participated in a DC plan. A study of the Nebraska Public Employees Retirement System, conducted by a national actuarial consultant, found that 68% of terminating participants cashed out their assets rather than rolling them over to another retirement plan. This finding is consistent with a Hewitt Associates study which found that more than two-thirds of participants terminating from DC plans cash out their lump sum distributions rather than rolling them to other retirement accounts.

In what follows, we outline the key advantages of DB plans to public sector employees and employers, seeking to illustrate how this paradigm for retirement provision is well-situated to meet retirement needs of the future.

Benefits to Employees

The ideal mix of retirement income sources has long been described as a 'three-legged stool,' with one leg each representing Social Security, an employer pension, and individual savings. As a rule of thumb, financial planners recommend replacing approximately 70–80 percent of one's working income in retirement. Public sector DB plans help achieve this goal by linking employee salary and retirement income: thus a Social Security-eligible employee retiring with twenty years of service in a typical public pension plan can expect the benefit to replace 35–40 percent of his salary. Combined with Social Security and personal saving, the retiree then finds the 70–80 percent target within reach. Retirees and beneficiaries of public DB plans received annual benefits of over \$18,000 in fiscal year 2002 (Brainard 2004).¹ In addition to the basic DB plan, many public employers today also offer a voluntary, supplemental retirement saving plan which enables workers to save on their own for retirement. The most popular public employer-sponsored supplemental savings plans are 457 plans, also known as deferred compensation plans, and 403(b) plans, commonly referred to as TSA's or tax-sheltered annuities.

Retiree financial independence relies heavily on the guaranteed income replacement concept provided by a DB plan, and it also relies on the central concept that the retiree will continue to receive benefits until death. Further, most public DB plans provide joint and survivor annuity options, to ensure that spouses and other named beneficiaries will continue to receive a benefit even in the event of the death of the retiree (Mitchell and Hustead 2001). By contrast, DC plans do not guarantee access to a life annuity nor joint and survivor benefits.

A factor receiving increasing attention in recent years is the point that public DB assets are held in trust for participants; the assets are normally administered by a governing board whose members are legal fiduciaries. Unlike private industry DB plans, which can be curtailed in the event of the plan sponsor's bankruptcy, public pension benefits generally cannot be reduced. That is, ERISA protects only private sector DB benefits that have already accrued, while it does not protect the right to future benefit accruals. Constitutional provisions governing contract and property rights are generally interpreted as protecting not only accrued benefits but also future benefit accruals. This practice varies from state to state, with some state constitutions explicitly protecting pension benefits, while in other cases, statutes and case law expressly forbid cutting pension benefits. By contrast, state and local laws generally afford participants far greater protections, prohibiting public employers from diminishing the benefit formula, often with respect to future accruals. Another advantage of public plans is that most provide some form of protection against inflation. Since the median life expectancy of a 65-year-old woman is 22 years in the USA,

inflation of just 2 percent will cut purchasing power by more than one-third over the retirement period. Public plans offer several mechanisms for adjusting benefits post-retirement, including with periodic adjustments subject to legislative approval, automatic increases linked to the inflation rate, and annual automatic increases of a flat percentage or dollar amount (Brainard 2003).

Benefits to Employers

Pensions were introduced in the public sector to help public administrators attract and retain quality workers, to provide them with performance incentives, and to retire them in an orderly fashion (Eitelberg 1997). It is worth recognizing that governments, in their dual roles as both employers and policymakers, are uniquely situated to promote retirement financial security and serve as models for private industry, in their capacity as employer to more than one in ten working Americans.

The diversity of the public sector workforce has few, if any, peers in private industry, and attracting and retaining such a workforce requires a concerted and ongoing effort. For instance, just a few of the numerous positions maintained by US public employers include game wardens and garbage collectors, school teachers and environmental scientists, elected officials and insurance analysts, psychiatrists and custodians, historians and police officers, prison guards and firefighters, and college professors, among others. Each of these positions requires a different set of skills, knowledge, and abilities; exhibits differing demographic features and career patterns; and has unique requirements for recruitment, retention, salary, and compensation. As Mitchell and Husted (2001: 15) note:

One reason why pension plans differ (from those in private industry) is that they cover employees with different employment characteristics. For instance, because police work and fire fighting are physically demanding occupations, retirement benefits for public safety workers typically allow retirement at earlier ages, in part to maintain a younger workforce. Consequently, the retirement benefits available to police and firefighters are usually different from those provided to teachers or to general employees.

Similarly, pensions for judges typically are intended to reflect that, as a group, judges are older than most other employees when entering their positions, and they often forgo larger salaries in private industry to serve as judges. Since protecting and educating its citizens is generally considered to be a government's core responsibilities, it should be no surprise that more than half of all public employees work in positions classified by the US Bureau of Labor Statistics (2002) as either Education or Protective Service. More than nine million public employees are classified as educational (including teachers, administrators, and workers in supportive

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roles), and there are approximately one million law enforcement personnel and firefighters in the USA.

Not only do public DB plans attract a diverse group; they also promote retention efforts by rewarding length of service. This is because DB plan formulas usually base the retirement benefit on a worker's salary during his final years of service and on his length of service. Since salaries tend to rise over time, DB plans typically calculate pension benefits based on the worker's final three or five years (final average salary or FAS). As the workforce changes, all employers will be challenged to compensate workers who possess required knowledge, skills, and institutional memory (see Chapter 7). DB plans may be key to retaining quality employees.

DB plans also encourage orderly turnover of personnel by allowing employees to depart from the workforce with a clear knowledge of their pension benefits and with the assurance that the benefit payment will continue for life. By contrast, the DC plan provides no assurance that an employee will be financially prepared for retirement at any specific age or level of experience. Unfortunately this uncertainty (or, in some cases, certainty of the inadequacy of one's benefits) causes employees to remain on the job even when their ability to perform job duties is in decline. Clearly this may also complicate the employer's role, forcing decisions with unpleasant consequences for everyone.

In recent years, public DB plans have grown more flexible in their ability to meet a range of new employer (and employee) objectives. Developments include shorter vesting periods; a majority of public employees now participate in plans with a vesting period of five years or fewer, down from ten years a decade ago. In addition, many large statewide public retirement plans now allow participants to purchase service earned at another retirement system or in the military. Also many plans now permit terminating participants to take all or part of the employer contributions, and some allow retired participants to return to active employment while continuing to receive their pension benefits. The number of public sector hybrid plans, having both DB and DC plan characteristics, has risen, as has the number of plans permitting retiring participants to take a portion of their benefit as a lump sum at retirement. Some plans also now permit participants to share in investment earnings during the accumulation period.

Another feature of DB plans particularly valuable to public employers is their ability to help public employers temporarily adjust the criteria used to determine retirement eligibility (typically, age and years of service requirements). Such incentives target employees who qualify already for retirement or who are close to qualifying, many of whom may be older and have more experience and salary than other employees. Once the worker retires, his position can be held vacant temporarily or permanently, or he may be replaced with lower-paid employee. Structured and managed properly,

early retirement incentive plans have been deemed useful to public employers, especially in the short-term.

Public DB plans as Financial Engines

A not-yet-discussed beneficial aspect of public DB plans is that their assets promote economic growth and vitality. Through their size, broad diversification, and focus on long-term investment returns, public pension funds stabilize and add liquidity to US and foreign financial markets. The Board of Governors (2004) reported that the \$2.3 trillion held by public retirement systems equaled over 20 percent of the nation's entire gross domestic product and approximately 20 percent of the nation's total retirement market. Public pension assets are well-diversified: approximately \$1.3 trillion of public pension assets are held as corporate equities; \$800 billion is in US treasury notes and bonds and corporate debt; and another \$90 billion is in real estate and mortgages (Board of Governors 2004). Most of these assets are invested on a long-term basis, while public pension cash and short-term holdings add essential liquidity to financial markets.

The cost of public pension funds to taxpayers, which is generally reported as employer contributions was \$38.8 billion (in FY 2002). Public pensions paid over \$110 billion in benefits in FY 2002, and a substantial majority of these funds derived from sources other than employer (taxpayer) contributions—mainly investment gains and employee contributions. Over the two-decade period from 1983 to 2002, public pensions had total receipts of \$2.7 trillion: investment earnings represented \$1.65 trillion of all system receipts, dwarfing employer (government) and employee contributions (US Census Bureau 2003). Through professional asset management and benefiting from favorable investment markets, public funds leveraged contributions from employers and employees into sizable investment earnings during the 1980's and 1990's. The sources of public pension revenue are summarized in Figure 12-1.

It is worth noting that these revenue sources shifted dramatically between 1983 and 2002, with investment earnings rising from 42 percent in 1983 to 62 percent in 2002. Meanwhile, the employer (taxpayer) share of cumulative public pension revenue declined from 42 percent to 26 percent. Unlike DB plans in private industry, most public DB plan participants contribute to their plans: 13 percent of public pension contributions came from employees during this period, and investment earnings made up the remainder. The time-series change in the distribution of revenue sources is depicted graphically in Figure 12-2.

By sponsoring DB plans with professional investment functions, instead of DC plans with assets managed by individual plan participants, public employers increased the value of retirement plan assets by an amount greater than the entire cost of their contributions during this same period.

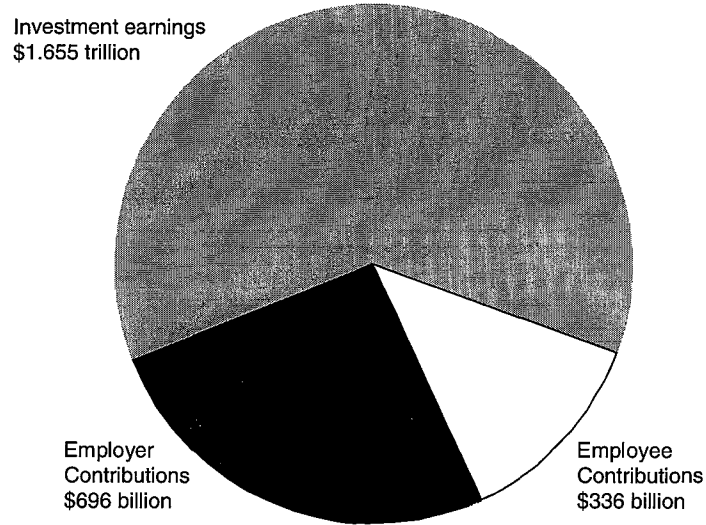


Figure 12-1. Sources of public pension revenue.
 Source: US Census Bureau (2002).

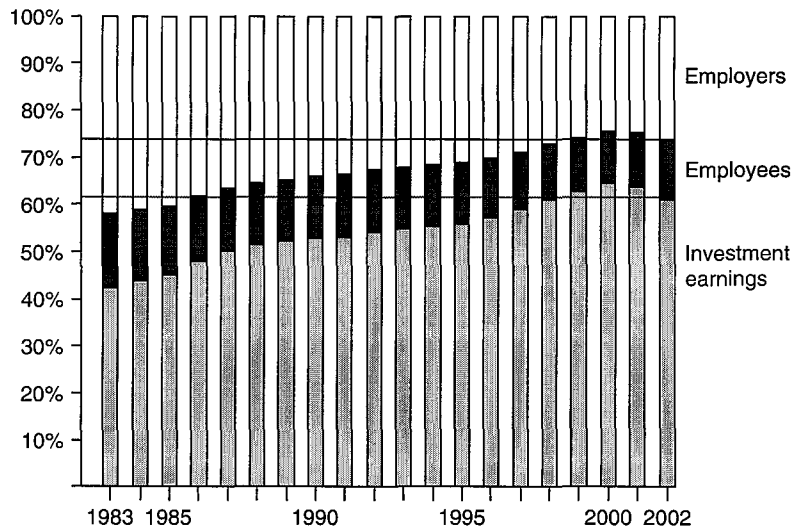


Figure 12-2. Changes over time in public pension fund revenue by source, 1983–2002.
 Source: US Census Bureau (2002).

Venture capital provides financing for new and rapidly growing companies; the innovations and efficiencies generated by start-up companies are considered critical to long-term economic growth. In the last decade, many public retirement systems have established target allocations to venture capital projects within their own state (PSRS/NTRS 2002). These investments seek to provide a return to the pension fund commensurate with the investment's level of risk, and also to promote economic growth and development in the state. Venture capital typically requires at least ten years to fully mature, making it a natural match for DB assets (McDonald 2002). This is because of DB funds' focus on long-term investment results and because these funds pool assets for large numbers of participants, accumulating portfolios large enough to commit to venture capital projects. In addition, DB plans also invest in other asset classes with the same long-term focus they demonstrate with venture capital.

As consumers, retired pension participants spend their benefits on a range of goods and services. These expenditures increase economic demand and promote employment, generating additional economic activity, which begets additional demand and employment. This is known as the multiplier effect: the effect of a single dollar has an economic impact greater than one dollar as it ripples through the economy. In an analysis described in more detail in the Appendix, we estimate the impact of the higher earnings from DB plans versus those available from DC plans which take into account lower investment earnings. We evaluate the impact of these higher investment gains on the gross product of the five states with the largest public pension distributions in fiscal year 2002 (California, New York, Texas, Ohio, and Illinois). In particular, we assume a marginal propensity to consume (MPC) of 0.67, which implies an economic multiplier effect of 3.0. Benefit payments from these five states comprised approximately 44 percent of the \$110 billion in public pension benefit payments in FY 2002. The difference between the actual benefits distributed by DB plans, and the estimated value of available DC benefits in these states of \$25.78 billion, represents the marginal value added by public DB plans as a result of their investment returns over the inferred value of available DC benefits (see Table 12-1).

Next we compute for each of the five states the value added to the gross state product (GSP) by the higher payments from DB plans attributed to superior investment returns. The value added, shown on Table 12-1, is determined by multiplying the marginal value-added by public DB plans' higher investment returns by the economic multiplier of 3.0. The table also shows the percentage value added to each state's gross state product, which in these five states totaled a weighted average of 2 percent to states' GSP. If we were to extrapolate these computations to the entire economy, a national 2.0 percent impact would yield a value added from public DB plans of \$203 billion: $\$10.137 \text{ trillion (GDP)} \times 2.0\% = \203 billion . This contribution

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TABLE 12-1 Estimated Benefits from DB and DC Plans, Assuming Lower Returns to DC Investments, 2002 (in \$ billions)

<i>State</i>	<i>Actual benefit payments made by public DB plans</i>	<i>Assumed payments from DC plans</i>	<i>Value added by higher DB plan returns</i>	<i>2001 Gross state product</i>	<i>\$ Value Added to Gross state product by higher returns</i>	<i>% Value Added to Gross state product by higher returns</i>
California	14.88	6.20	8.68	1,359.27	26.05	1.9
New York	12.48	5.20	7.28	826.49	21.85	2.6
Texas	5.87	2.45	3.42	763.87	10.28	1.3
Ohio	5.62	2.34	3.28	373.71	9.85	2.6
Illinois	5.36	2.24	3.13	475.54	9.39	2.0
Total	44.21	18.43	25.78	3,798.88	77.42	2.0

Note: Columns may not add due to rounding.

Source: United States Dept of Commerce (2003).

to the nation's economy dwarfs the employer contributions of \$39 billion to public retirement systems in FY 2002. Indeed, setting aside all the other benefits to employers and employees of DB plans, contributions to public pension plans may be among the best investments a state or local government can make.

Conclusions

The economic boost of public pension benefits is likely to grow as public employees of the baby boomer cohort begin to retire, and public retirement systems begin to pay out increasingly larger benefit amounts. In our view, public pension plans are in a strong position to handle the coming influx of retirees, since, unlike Social Security (mainly a pay-as-you-go program); public pensions are rather well-funded (approximately 95 percent in 2003). Investing the \$2.3 trillion in public pension assets and the flow of benefit payments to annuitants promises a continuous, predictable, and growing source of economic stimulus. Moreover, through efficient asset management and pooling of resources, public DB pension plans have a significant, positive effect on financial markets and the economy.

In general, public employers recognize that DC plans have many positive attributes, but to make them work well, many factors must fall into place: participants must consistently make sound investment decisions over their working and retired lives; they must remain in the workforce steadily, avoiding lengthy time-off for having children, raising a family, completing an education, or for illness; they must have a sufficient amount withheld from their pay; they must avoid borrowing against and spending their

retirement assets; and they must make appropriate decisions regarding withdrawal rates during retirement. Even then, employees might exhaust their assets after retirement. Hence having a DB plan as the primary retirement benefit protects public sector employees against many of these problems.

Public DB pension plans have also enabled public employers to achieve important objectives related to the recruitment and retention of quality workers. These plans provide financial security in retirement and reduce retiree reliance on public assistance programs. The fact that these plans have evolved relatively independently of the federal regulatory structure governing private pensions has allowed the public plans to engage in an ongoing process of creating and modifying plan designs and governance structures to meet the unique needs of public sector employers. The independence, flexibility, and profitable prudence of these plans will continue to support public employers in their ongoing mission to serve taxpayers, while providing financial security to retired public employees and significant economic benefits to their communities. Public plans are, indeed, a useful component of the new retirement paradigm of the future.

Technical Appendix

The multiplier effect described in the text is based on the MPC which refers to the proportion of each additional dollar of household income used for consumption. As Keynes (1936) noted, people tend to consume more if their income rises, but this consumption gain tends to be less than the rise in their income. The MPC states that a worker who receives an increase in salary of \$100 per month will spend some, but not all, of the entire \$100; savings and taxes will make up the difference. It can be expressed as a formula: $MPC = \Delta I - MPS - t$, which simply means that the marginal propensity to consume equals the change in income minus savings minus taxes. The multiplier effect can be derived from the MPC as $1/(1 - MPC)$.

To compare actual benefits paid by public DB pensions and the benefits that might have been payable by DC plans earning lower assumed investment returns, we reduced by ten percent the amount paid by public DB pensions to reflect migration of retired participants from the five states. This reduces the DB payments figure to \$44.2 billion. For the 20-year period ended in 2002, public DB plans experienced annualized investment returns of 10.03 percent. As a base of comparison, using the Nebraska benefits adequacy study and the Investment Company Institute report on the asset allocation of 403(b) and 457 plan participants as a guide, we assume a net annualized investment return for DC plans during the same period of 6.5 percent. Based on these rates, the DC plan portfolio would have returned 41.7 percent of the investment gains accrued by the DB plan. Applying this proportion—41.7 percent—of the investment earnings DC

plans would have generated, to the benefits actually distributed by public DB plans in the five states, yields \$18.4 billion. This amount is referred to here as the *inferred value of available DC benefits*, and represents a level of assumed DC plan benefits that can be compared with the amount actually distributed by DB plans.

While this exercise illustrates how public DB plans can have a positive effect due to their superior investment returns, relative to DC plans, there are other factors that must also be mentioned. For instance, we assumed that DC plans would pay benefits in the same proportion to their investment earnings as DB plans, but in fact we cannot know at what rate DC plan assets will actually be spent. Also we assumed that DC and DB contribution rates would have been the same. In view of the fact that some DB contributions over this period were actually intended to reduce underfunding, it is possible that contributions to DC plans would have been lower than these. In any event, our central finding—that DB contributions yield positive long-term economic results—suggests that higher contribution rates literally have been a good investment, not only for taxpayers, but also for public employers and employees. Additionally, this analysis assumed a consistent contribution rate relative to investment gains and benefit payments, though actual contribution rates varied across states. Also we did not attempt to determine additional tax revenues generated by higher DB payments; rather we assumed that the DC and DB plans produced similar rates of leakage, though most public DB plans do not permit loans. Finally, we assumed that the administrative cost of the plan types is identical, though public DB plans typically have administrative expenses considerably lower than those of DC plans. Factoring this in would likely strengthen the case for the economic value of DB versus DC plans.

Endnote

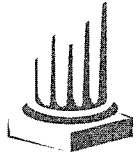
The authors wish to acknowledge the significant contributions made to this paper by Cathie Eitelberg, Gary Johnson, Jeannine Markoe Raymond, Bill Wallace, and Paul Zorn.

1. For the 25 percent of state and local government employees who do not participate in Social Security, pension benefits are generally higher to compensate for the absence of Social Security benefits.

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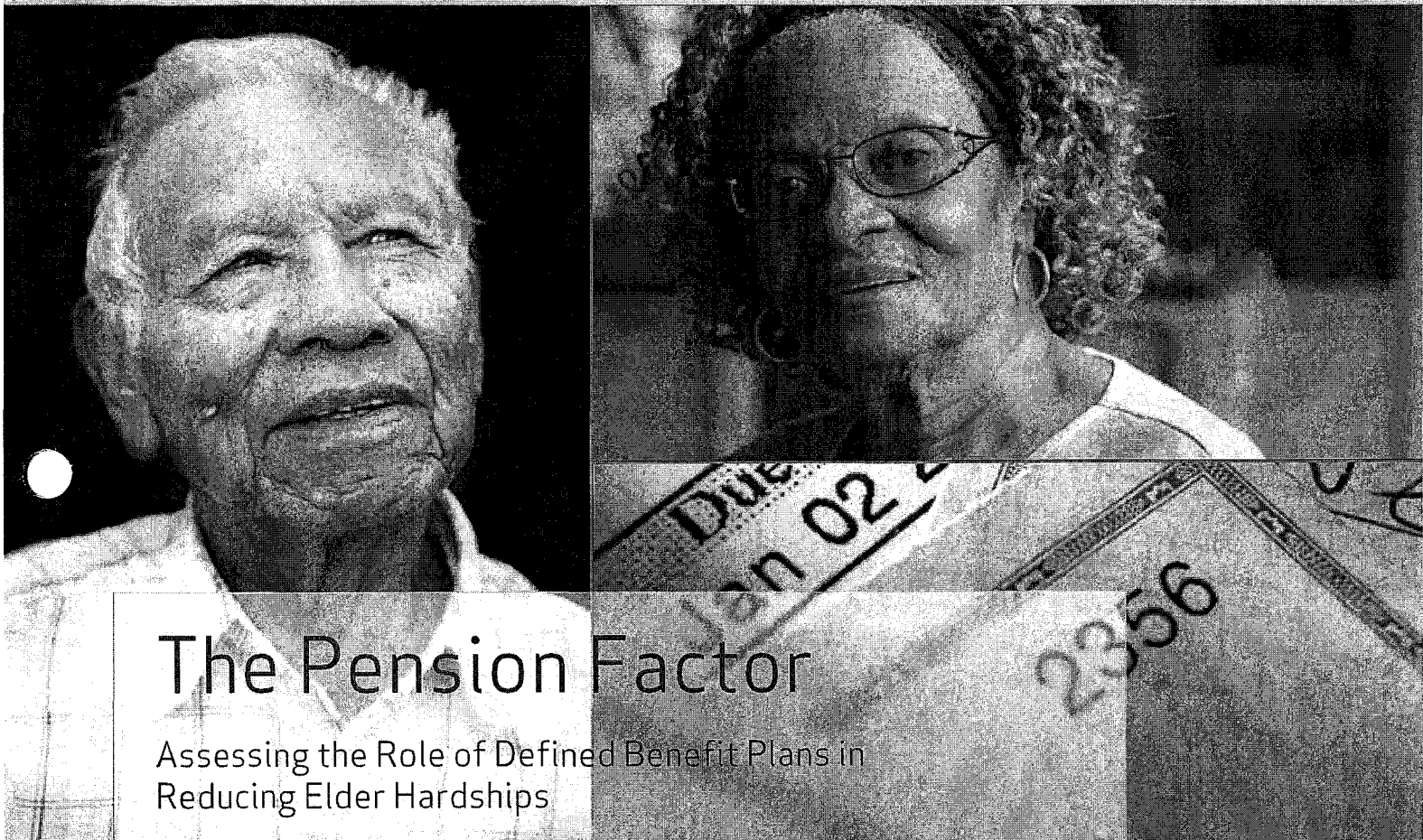
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The Pension Factor

Assessing the Role of Defined Benefit Plans in
Reducing Elder Hardships

by Frank Porell, Ph.D and Beth Almeida

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EXECUTIVE SUMMARY

Recent turmoil in financial markets has substantially reduced the retirement savings of many workers and retirees alike. This has heightened public concerns that many older American households will not accumulate sufficient retirement savings to meet their needs in retirement. Fortunately, about half of older American households count on income from a defined benefit (DB) pension.

The predictable monthly benefits provided by DB plans remain a source of security to these retired households, enabling millions of Americans to remain secure and independent in old age. This study analyzes the contribution of DB pensions to the economic security of older American households.

Our findings indicate that DB pension income plays a vital role in reducing the risk of poverty and material hardships among older Americans. Rates of poverty among older households without DB pension income were approximately six times greater than the rate among older households with DB pension income. Older households with DB pension income also were far less likely to experience food, shelter, and health care hardships. In addition, DB pension recipient households were less reliant on means-tested cash and non-cash public assistance.

While households with DB pension income generally fared better than households without pension income, DB pensions appear to have particularly improved the economic security of more vulnerable subpopulations of elder households. Our analysis suggests that common gender and racial disparities in rates of poverty, material hardships, and dependence on public assistance are greatly diminished, and in some cases nearly eliminated, among households receiving DB pension income.

Even after controlling for a range of socio-demographic factors such as education, race, gender, and work history, we find that households with a pension fare better than those without. In other words, DB pensions appear to exert an independent, positive effect on older Americans' economic well-being – an effect we call the “pension factor.”

This “pension factor” has helped substantial numbers of older American households avoid material hardships associated with inadequate food, shelter, and health care and to avoid having to rely on public assistance. More specifically, we estimate that in 2006, DB pension receipt among older American households was associated with:

- 1.72 million fewer poor households and 2.97 million fewer near-poor households
- 560,000 fewer households experiencing a food hardship
- 380,000 fewer households experiencing a shelter hardship
- 320,000 fewer households experiencing a health care hardship
- 1.35 million fewer households receiving means-tested public assistance

We calculated a savings of some \$7.3 billion in public assistance expenditures in 2006, not counting Medicaid reimbursements for acute and long-term medical care, which can be attributed to receipt of DB pension income. Our estimates of savings represent about 8.5 percent of aggregate public assistance dollars received by all American households in 2006 for the same benefit programs. This amount is significant, particularly given the pressures on safety net programs during the current fiscal crises experienced at all levels of government throughout the country.

INTRODUCTION

Traditional defined benefit (DB) pension plans have long been an important source of income for elder households seeking to maintain a middle-class standard of living after a lifetime of work. Under traditional DB plans, retirees receive a guaranteed, regular stream of income after retirement that continues until death.

The monthly pension benefit is typically based on years of service to the employer, age, and salary history. Retirees also have the option to elect a joint-and-survivor benefit, to ensure that pension payments continue to a surviving spouse. DB plan participation rates among private sector American workers have sharply decreased from about 38 in 1980 to 20 percent in 2008.¹ DB plan coverage in the public sector has not followed this same trend. Overwhelmingly, employees of local, state or federal government are covered by a traditional pension plan. For the same time period, the percentage of private sector workers covered by a defined contribution (DC) retirement plan, such as 401(k) plans, rose from 8 to 31 percent. Under such DC plans, employers and/or employees make contributions to a retirement savings account. Employees typically need to decide how to invest these sums in order to produce accumulated savings for income at retirement.

Recent turmoil in financial markets has substantially reduced the DC plan retirement savings of many workers and retirees alike. This has heightened public concerns that many older American households will not accumulate sufficient retirement savings to meet their needs in retirement. Although investment losses certainly have adversely affected the funding of many DB plans, the predictable monthly benefits of DB plans remain a source of security to retired households who have these plans.²

Evidence of the contributions of DB pensions to the retirement readiness of households has been noted long before the current crises in financial markets. For example, projections by Munnell, Webb, and Golub-Sass show that households with heads born after 1945 with a DB plan are about twice as likely than their counterparts with only a DC plan or no retirement plan at all, to have adequate replacement retirement income

at age 65, or income that is sufficient for roughly maintaining one's pre-retirement standard of living.³ Other experts have shown that DB pensions are a major income component for both middle and upper income retirees.⁴ Whereas DB pension income comprised only about 3 percent of total household income among the poorest elderly households in the bottom quartile of the household income distribution in 2007, it comprised about 21 percent and 15 percent of income among households in the top two household income quartiles, respectively.⁵

A review of the evidence in studies such as those noted here finds a compelling case for the vital role that DB pensions play in ensuring economic self-sufficiency of retired American households.⁶ Several distinctive features of DB pensions should be noted as contributing factors. First, eligible employees are automatically included in DB plans and do not face decisions about whether to participate, how much to save, and how to invest the savings. Second, DB plans better protect retirement wealth from pre-retirement "leakages" due to borrowing or pre-retirement withdrawals. Third, DB pension recipients can't outlive their retirement benefits, and a spouse's access to this pension income is protected after one's own death. Because of these unique features of DB pension plans, older American households with pension income should have greater economic security than their counterparts without such income. However, this proposition has not been examined empirically in past research.

In this report we undertake an empirical examination of the contribution of DB pension income in enhancing the economic welfare of older American households. We use data from the U.S. Census Bureau's Survey of Income Program Participation (SIPP) to examine who receives pension income,

how much, and how this has changed over time. We then assess the extent to which DB pension income has protected older American households from poverty in general, and also from experiencing various food, shelter, and health care hardships. We provide descriptive statistics for the older population as a whole, as well as for distinct demographic groups. Lastly, and perhaps most importantly, we derive estimates of the effect of DB pension receipt in reducing older households' reliance on public assistance, and the associated savings to governments in public assistance expenditures.

Data Source and Study Sample

The study data were drawn from 1996, 2001, and 2004 panels of the SIPP.⁷ Each SIPP panel is a representative national sample of the civilian population not living in institutions. SIPP Panel members are interviewed at four-month time

intervals over 3-4 year time spans, so the 2004 SIPP panel, for example, incorporates data from 2004 through 2006. A core set of income, labor force, and program participation questions are asked at each interview. Additional questions on a variety of topics such as pension plan coverage, adult well-being, employment history, or health are also asked at specific interviews in the form of topical modules. Topical module questions are asked in only one of the 9-12 interviews conducted during the multi-year span of the panel survey. For this study, core interview variables were used from questions asked in the same month of the Retirement and Pension Plan Coverage topical module. Material hardship variables were obtained from the Adult Well-Being topical module conducted in a different month. The study sample included all SIPP respondents age 60 years or older and all households with a head age 60 and older, respectively, who had records in both the Pension and Adult Well-Being topical modules.⁸

PENSIONS REMAIN AN IMPORTANT SOURCE OF INCOME FOR MIDDLE-CLASS RETIREES

Table 1 presents descriptive statistics about persons who have received DB pension income, how much they received, and how this has changed over time from SIPP data. Receipt of a DB pension is defined here as receiving regular pension income from a former employer for reasons of retirement, disability, or survivorship that are expected to last for the remainder of one's life.

Similar to past research using SIPP data,⁹ lump sum pension distributions are not counted as DB pension income. According to these data, about 31.5 percent of persons age 60 or older in the U.S. received DB pension income from a former employer of their own in 2006. The mean and median annual pension amounts received in 2006 were about \$15,784 and \$11,467, respectively.¹⁰ While appropriate for many purposes, this definition of pension receipt does not include survivors who receive DB pension income from a job held by a former

decedent spouse, or persons who benefit from the DB pension income of their current spouse. When these sources of DB pension income are also counted, the 2006 estimated rate of DB pension receipt increases to 48.2 percent of persons age 60 or older, with mean and median annual pension amounts per recipient of \$18,195 and \$12,480, respectively. The higher mean and median pension amounts under this broader definition of DB pension receipt are the result of counting both pension incomes of dual-recipient married couples.¹¹

Table 1: DB Pension Income Among Persons Age 60 or Older, 1998, 2003, and 2006

		Persons Age 60 or Older with DB Pension Income from Own Former Employer	Persons Age 60 or Older with DB Pension Income from Own or Spouse's Former Employer
2006	Percent of Persons with DB Income	31.5%	48.2%
	Mean Pension Amount ^a	\$15,784	\$18,195
	Median Pension Amount ^a	\$11,467	\$12,480
2003	Percent of Persons with DB Income	34.1%	51.8%
	Mean Pension Amount ^a	\$14,592	\$16,960
	Median Pension Amount ^a	\$10,477	\$12,255
1998	Percent of Persons with DB Income	33.5%	51.8%
	Mean Pension Amount ^a	\$12,987	\$14,696
	Median Pension Amount ^a	\$9,257	\$10,603

Source: Tabulations from the 1996-98, 2001-03, and 2004-06 Surveys of Income and Program Participation, Core wave 7 and Topical Module 7
 a All Dollars are in 2006 dollars.

Although there have been dramatic declines in DB pension plan participation among private sector workers since the early 1980s,¹² the data in Table 1 suggest that these declines in plan participation have not yet produced sharp declines in rates of actual DB pension income receipt among older Americans. A fairly modest decline is observed in the percentage of persons aged 60 or older receiving DB pension income between 1998 and 2006. The similar estimated rates of DB pension receipt in 1998 and 2003 are only about 2 to 3 percentage points higher than the 2006 estimates, regardless of how broadly pension receipt is defined. In all three years prevalence rates of DB pension income receipt are about 16 to 18 percentage points higher when spousal sources of pension income are considered relative to when they are not. Since many workers affected by the shift toward DC plans over the last two decades may have not yet retired from the labor force, future data may show more marked declines in DB pension receipt than is apparent in 2006 data.

Gender and Race

Table 2 shows how rates of DB pension income receipt varied with selected characteristics of older Americans in 2006.¹³ Older men are nearly twice as likely as women to report DB pension income from a former employer (42.0 percent vs 23.3

percent) and the amounts received are substantially larger as well. The mean annual pension from a former employer among older men of \$18,040 is more than 40 percent greater than the mean of \$12,589 among women. These gender differences reflect the historical lower rates of labor force participation and earnings of women relative to men for this older population cohort.¹⁴ When spousal sources of pension income are counted in the broader definition of DB pension receipt, the gender disparity in pension amounts received are substantially reduced and the gender disparity in DB pension receipt is nearly eliminated (49.8 percent vs 46.9 percent). A little more than 60 percent of the marginal increase in the rate of DB pension receipt among women under the broader definition stems from being a current spouse of a current DB pension recipient, with the rest attributable to counting DB pension survivor benefits.

Table 2 also indicates there are notable racial/ethnic disparities in DB pension income receipt among older Americans. However, the pattern of changes in race/ethnic disparities under the alternative definitions of DB pension receipt differ from those found for gender. When DB pension receipt is based only on pension income from one's own former employer, rates of DB pension receipt among older non-Hispanic White and Blacks were similar (32.7 percent vs 32.0 percent) and were

Table 2: DB Pension Income Among Persons Age 60 or Older by Selected Characteristics, 2006

	Number of Persons (millions)	DB Pension from Own Former Employer Only			DB Pension from Own or Spouse's Former Employer		
		Percent	Mean Pension Amount ^a	Median Pension Amount ^a	Percent	Mean Pension Amount ^a	Median Pension Amount ^a
All	48.6	31.5%	\$15,784	\$11,467	48.2%	\$18,195	\$12,480
Gender							
Male	21.4	42.0%	\$18,040	\$13,509	49.8%	\$19,906	\$14,364
Female	27.2	23.3%	\$12,589	\$8,400	46.9%	\$16,763	\$11,664
Race/Ethnicity							
Non-Hispanic White	39.1	32.7%	\$16,136	\$11,730	50.7%	\$18,609	\$12,908
Non-Hispanic Black	4.2	32.0%	\$13,857	\$9,592	42.8%	\$15,565	\$11,042
Other Race/Ethnicity	5.3	22.6%	\$14,225	\$10,629	34.0%	\$16,298	\$11,976
Annual Household Income^b							
Lowest Quintile	10.9	15.6%	\$4,330	\$2,952	24.4%	\$4,782	\$3,283
2nd Quintile	12.7	32.1%	\$9,231	\$7,665	49.7%	\$9,193	\$7,656
3rd Quintile	11.2	40.3%	\$15,597	\$13,173	61.7%	\$17,493	\$15,600
4th Quintile	8.0	39.1%	\$23,487	\$20,359	59.1%	\$28,769	\$27,950
Highest Quintile	5.8	32.6%	\$27,933	\$23,952	47.8%	\$35,335	\$30,574
Census Region							
Northeast	9.6	34.4%	\$14,015	\$9,796	50.7%	\$16,225	\$10,800
Midwest	11.1	32.4%	\$14,191	\$10,536	50.3%	\$16,127	\$11,760
South	18	29.3%	\$15,428	\$11,161	45.8%	\$17,895	\$12,144
West	9.9	31.8%	\$20,036	\$14,364	47.6%	\$23,188	\$16,462
Employment Sector							
Private Only	9.8	63.6%	\$11,183	\$7,782	14.7%	\$12,282	\$8,739
Public Only	4.5	29.2%	\$21,916	\$18,563	35.0%	\$25,130	\$20,947
Both	1.1	7.1%	\$32,068	\$26,633	50.3%	\$34,429	\$29,172

Source: Tabulations from the 2004-2006 Survey of Income and Program Participation, Core wave 7 and Topical Module 7

a All Dollars are in 2006 dollars.

b Quintile ranges are those reported by the U.S. Bureau of the Census for households with heads of all ages. Quintile boundaries (lowest to highest) are: \$20,135; \$37,774; \$60,000; \$97,032.

much higher than for persons of other race/ethnicity (22.6 percent). When spousal sources of DB pension income are counted, a White-Black racial disparity in DB pension receipt emerges (50.7 percent vs 42.8 percent). However, the mean and median income received by White pension recipients

exceeded that pension recipients of all other race/ethnic groups regardless of whether spousal pension income is counted or not. These data suggest that there may be disproportionately more married persons and persons with DB survivor benefits among older Whites relative to Blacks.

Income and Geography

When the data are displayed by household income quintiles in Table 2, they show the expected results that older persons with lowest household incomes are least likely to have DB pension income and, on average, receive the smallest pension amounts. Similar to other researchers,¹⁵ SIPP data suggest that DB pension income is a particularly important income component for middle-class older Americans. Whereas mean and median pension amounts received increase monotonically from the lowest to the highest household income quartiles, rates of DB pension income receipt are highest among older persons in the third and fourth quintiles of the national distribution of annual household income.

Table 2 also contains data on the geographic variations in rates of DB pension receipt and pension amounts. Although regional disparities are generally modest, lower rates of DB pension receipt are found among older persons living in the South relative to other regions, and recipients living in the West receive larger pensions relative to other regions. These regional disparities are not surprising given the history of lower rates of unionization in the South and the higher living costs and wages of workers in the West region of the United States.¹⁶

Public and Private Sector

Finally, Table 2 shows the number of older persons with private and public DB pension income and the amounts received. Public pensions include civilian and military federal government, state government, local government, and Railroad Retirement Board pensions. Private pensions include company, union, and other nongovernment retirement pensions. Regardless of how pension receipt is defined, private DB pension recipients greatly outnumbered public DB pension recipients in 2006. Almost 71 percent of DB pension recipients in 2006 received some private pension income, either alone (63.7 percent), or with public pension income (7 percent). A little more than 36 percent of DB pension recipients received some public pension income, either alone (29.2 percent), or with private pension income (7 percent). When spousal sources of pension income are also considered, the percentage of the much larger pool of pension recipients with some public DB pension income remains about 36 percent, while the percentage of pension recipients with some private DB pension income increases to 74.5 percent.

While far fewer in number, public DB pension recipients generally received far greater annual pension income than their private DB pension recipient counterparts. The mean and median annual amounts of pension income of \$21,916 and \$18,563 among recipients with only public pensions were roughly 2 and 2.4 times greater than the mean (\$11,183) and median (\$7,782) amounts received by DB pension recipients with only private pensions in 2006.¹⁷ The relatively small pool of DB pension recipients with both private and public pensions received much larger pension incomes than their counterparts with only public or private pension income even when pension receipt is based solely upon one's own former employment. When spousal sources of pension income are also considered, there is a modest increase in the disparity between private and public pension amounts received by recipients. Similar disparities in the size of public and private DB pensions have also been documented by others.¹⁸ The greater income received by public relative to private DB pension recipients reflects the fact that nearly all state and local government employees contribute to their pensions, while employees in the private sectors do not.¹⁹ Also, because many state and local employees are not covered by Social Security, these DB pensions compensate for that lack of coverage. Other factors that also play a role are lower job turnover and longer employment tenure among government employees, as well as their occupational mix and higher education levels.²⁰

Pension Income Compared to Other Retirement Income

Some perspective on the magnitudes of both the rates of DB pension receipt and amounts received by older persons can be found in Table 3. This table presents comparative data on estimated receipt rates and the mean and median annual amounts of DC and Social Security income received by older Americans in 2006. These data show that DC income receipt rates were much lower than the receipt rates of both DB and Social Security income, and the rate of Social Security income receipt was highest among the three sources of retirement income. While the mean annual income received was greatest for DC income recipients and lowest for Social Security income recipients, these rankings are reversed when median amounts received are considered.²¹ The median annual amount of Social Security income among recipients exceeded that for both DB and DC income recipients. For both DB and DC income, the mean amounts received are much larger than their median amounts. This differential suggests that the

distributions of amounts received by DB and DC recipients are more heavily skewed than for Social Security recipients. This

typically results when a relatively small fraction of individuals is receiving very large annual amounts relative to others.

Table 3: DB, DC, and Social Security Income Recipients and Amounts — Persons Age 60 or Older

	Number of Persons Receiving Income (millions)	Recipients as a Percent of All Persons	Mean Annual Amount ^a	Median Annual Amount ^a
DB Pension Income				
Own Former Employer	15.3	31.5%	\$15,784	\$11,467
Own or Spouse's Former Employer	23.4	48.2%	\$18,195	\$12,480
DC Income				
Own	2.5	5.1%	\$24,435	\$11,970
Own or Spouse's	3.5	7.2%	\$21,625	\$9,575
Social Security Income				
Own	37.6	77.4%	\$11,965	\$12,038
Own or Spouse's	39.7	81.6%	\$16,561	\$15,518

Source: Tabulations from the 2004-2006 Survey of Income and Program Participation, Core wave 7 and Topical Module 7

a All Dollars are in 2006 dollars.

HOUSEHOLDS WITH PENSION INCOME FACE FEWER RISKS OF POVERTY, HARDSHIPS

We now turn to the economic welfare of older American households with DB pension income relative to other households. Income offers a means for households to consume goods and services that are necessary to meet their basic needs. Therefore, income is widely accepted as an important indicator of economic well-being.

Comparing household incomes to thresholds, such as federal poverty levels, is a common way to assess the economic welfare of various subpopulations and changes in their economic welfare over time. For example, although poverty among older Americans remains an important policy concern, the percentage of older Americans living in poverty has declined markedly since the 1960's largely because of the growth in Social Security coverage and benefits.²²

Conventional poverty-level measures have a number of acknowledged limitations such as the exclusion of noncash

benefits (e.g., food stamps, housing subsidies) and earned income tax benefits. The measures also do not incorporate adjustments for expenditures that are not directly made for the consumption of necessities, such as childcare, taxes, various work-related expenses, as well as for geographic cost-of-living differentials.²³ Aside from these technical limitations, they measure resources available for consumption rather than consumption itself. Direct measures of material hardships have been developed from reported consumption patterns and physical living conditions judged to be inadequate by societal standards. Despite some shortcomings of their own,²⁴

material hardship measures provide a tangible picture of the actual consequences of inadequate economic resources for households. They are generally regarded as useful supplements to conventional income-poverty indicators for assessing economic well-being.²⁵ In Tables 4 through 6 below, we compare not only poverty rates, but also rates of selected material hardships among households with and without DB pension income.

Households with Pensions Less Likely to be Poor or “Near Poor”

Table 4 shows how poverty rates varied among older households with DB pension receipt status and selected characteristics of the householder. Since federal poverty thresholds of the U.S. Bureau of the Census are measured for families, we analyzed the family income received by SIPP households with a householder age 60 or older rather than income received individually by all older persons. Households with incomes below the federal poverty line (FPL) are classified as “poor.” Households with incomes exceeding the FPL but less than or equal to 200 percent of the FPL are classified as “near-poor,” while households with incomes exceeding 200 percent of the FPL are classified as “not-poor.” DB pension receipt pertains to both the householder and his/her spouse.

We find the expected large gender and racial disparities in poverty rates among older American households. But, the data also suggest that DB pensions can reduce gender and racial gaps.

In 2006 about 9 percent of American households with householders aged 60 or older were poor, and another 25.5 percent of them were near-poor. The poverty rate is much lower among older households with DB pension income relative to their counterparts with no DB pension income. This is not surprising because lower income workers are the least likely to be covered by a pension.²⁶ The poverty rate of 15.1 percent among older households without any DB pension income exceeded the 2.4 percent rate of households with DB pension income by more than a factor of six. In addition, the 33.9 percent rate of near-poverty among households without

DB pension income is more than double the near-poverty rate of 15.1 percent found for those with DB pension income. While still much lower than households with no DB pension income, poverty rates were much higher among households with only private DB pension income relative to those with only public DB pension income and those with both public and private pension income. These results are consistent with the larger pension amounts of public relative to private DB income recipients reported earlier in Table 2.

We find the expected large gender and racial disparities in poverty rates among older American households. But, the data also suggest that DB pensions can reduce gender and racial gaps. As shown in Table 4, older households headed by women generally exhibit higher poverty rates than those headed by men with the same DB pension status. However, female-headed households with DB pension income exhibit lower poverty rates than male-headed households without DB pension income. More importantly, the 4.3 percentage point female disparity in the percentage of poor households without DB pension income (16.8 percent vs 12.5 percent) is nearly eliminated among households with DB pension income (i.e., 2.5 percent vs 2.2 percent). Similar changes in racial disparities in poverty rates are found when DB pension receipt is distinguished. Poverty rates are generally much higher among non-White households relative to their White counterparts. However, the double-digit percentage point White-non-White racial disparity in poverty rates among households without DB pension income (11.5 percent for Whites vs 29.4 percent for Blacks and 24.6 percent for Other Race) is reduced to a disparity of less than 4 percentage points among households with DB pension income (1.9 percent for Whites vs 5.2 percent for Blacks and 4.7 percent for Other Race). These data suggest that DB pensions have helped many older non-white and female-headed households to escape poverty as defined by the FPL.

Households with Pensions Face Fewer Material Hardships

We analyzed three types of material hardships: inadequate food consumption, inability to meet basic expenses associated with shelter, and unmet medical or dental needs. Our selection of these hardship measures was guided by the findings of past research employing SIPP data on material hardships.²⁷ We discuss our empirical findings for each of these material hardship measures in turn.

Table 4: Percentage of Older Households with Household Incomes Exceeding Poverty Thresholds by DB Pension Income Status and Other Selected Characteristics, 2006

	Number of Households (millions) ^d	Percent of Households with Annual Income		
		Poor ^c	Near Poor ^c	Not Poor ^c
All Households	31.6	9.0%	25.5%	65.5%
With Own or Spouse Pension Income	15.0	2.4%	16.2%	81.5%
Private Pension	9.4	3.0%	20.9%	76.1%
Public Pension	3.9	1.3%	10.3%	88.4%
Both	1.7	1.4%	3.1%	95.5%
No DB Pension Income	16.6	15.1%	33.9%	51.0%
Gender of Head of Household				
Male				
With Own or Spouse Pension Income	6.9	2.2%	10.4%	87.4%
No DB Pension Income	6.5	12.5%	28.0%	59.5%
Female				
With Own or Spouse Pension Income	8.1	2.5%	21.1%	76.4%
No DB Pension Income	10.0	16.8%	37.8%	45.4%
Race/Ethnicity				
Non-Hispanic White				
With Own or Spouse Pension Income	12.7	1.9%	15.2%	82.9%
No DB Pension Income	12.7	11.5%	33.2%	55.3%
Non-Hispanic Black				
With Own or Spouse Pension Income	1.3	5.2%	23.3%	71.5%
No DB Pension Income	1.8	29.4%	37.8%	32.8%
Other Race/Ethnicity				
With Own or Spouse Pension Income	1.0	4.7%	18.1%	77.2%
No DB Pension Income	2.0	24.6%	35.3%	40.1%
Household Income^{a,b}				
Lowest Quintile				
With Own or Spouse Pension Income	2.2	16.0%	83.0%	1.0%
No DB Pension Income	6.9	35.7%	64.0%	0.3%
Quintile 2				
With Own or Spouse Pension Income	4.6	0.1%	12.3%	87.6%
No DB Pension Income	4.2	0.9%	26.9%	72.3%
Quintile 3				
With Own or Spouse Pension Income	4.2	0.0%	0.6%	99.4%
No DB Pension Income	2.3	0.0%	3.3%	96.7%

Source: Tabulations from the 2004-2006 Survey of Income and Program Participation, Core wave 7 and Topical Module 7. Older households are defined as those whose head is age 60 or older.

a Quintile ranges are those reported by the U.S. Bureau of the Census for households with heads of all ages.

Quintile boundaries (lowest to highest) are: \$20,135; \$37,774; \$60,000; \$97,032.

b Quintiles 4 and 5 are not reported because nearly all households are classified as "not poor"

c Poor: Income below Federal Poverty Level (FPL); Near Poor: FPL < Income <= 200% FPL; Not Poor: Income > 200% FPL.

d Totals may not add up due to rounding.

Table 5: Percentage of Older Households Reporting Food, Shelter, and Health Care Material Hardships by DB Pension Income Status and Other Selected Characteristics, 2006

	Number of Households (millions) ^b	Percent of Households Reporting: ^b		
		Food Insecurity Hardship	One or More Shelter Hardship ^c	One or More Health Care Hardship ^c
All Households	31.6	4.7%	4.6%	6.0%
With Own or Spouse Pension Income	15.0	2.6%	2.4%	4.2%
Private Pension	9.4	3.1%	2.9%	5.0%
Public Pension	3.9	1.9%	1.7%	2.8%
Both	1.7	1.6%	1.6%	2.7%
No DB Pension Income	16.6	6.7%	6.6%	7.8%
Gender of Head of Household				
Male				
With Own or Spouse Pension Income	6.9	2.3%	1.6%	3.8%
No DB Pension Income	6.5	5.7%	5.2%	5.8%
Female				
With Own or Spouse Pension Income	8.1	2.9%	3.1%	4.5%
No DB Pension Income	10.0	7.2%	7.5%	9.1%
Race/Ethnicity				
Non-Hispanic White				
With Own or Spouse Pension Income	12.7	1.9%	1.6%	3.6%
No DB Pension Income	12.7	4.8%	4.4%	6.9%
Non-Hispanic Black				
With Own or Spouse Pension Income	1.3	6.4%	10.1%	6.7%
No DB Pension Income	1.8	13.4%	18.0%	13.1%
Other Race/Ethnicity				
With Own or Spouse Pension Income	1.0	6.5%	2.3%	7.2%
No DB Pension Income	2.0	11.9%	10.1%	8.5%
Annual Household Income				
Lowest Quintile^a				
With Own or Spouse Pension Income	2.2	6.5%	4.7%	7.3%
No DB Pension Income	6.9	10.5%	9.4%	10.3%
Quintile 2				
With Own or Spouse Pension Income	4.6	3.4%	3.1%	5.7%
No DB Pension Income	4.2	5.9%	5.6%	7.7%
Quintile 3				
With Own or Spouse Pension Income	4.2	1.9%	2.0%	2.7%
No DB Pension Income	2.3	2.3%	3.7%	4.5%

Source: Tabulations from the 2004-2006 Survey of Income and Program Participation, Core wave 7 and Topical Module 7.

Older households are defined as those whose head is age 60 or older.

a Quintile ranges are those reported by the U.S. Bureau of the Census for households with heads of all ages.

Quintile boundaries (lowest to highest) are: \$20,135; \$37,774; \$60,000; \$97,032.

b Totals may not add up due to rounding.

c See Technical Appendix for definitions of food, shelter and health care hardship indices.

Table 5 shows rates of food hardships among older American households in 2006. Hardships associated with inadequate food consumption were based on a food security scale based on the U.S. Department of Agriculture (USDA) employed in previous research by She & Livermore.²⁸ The scale is derived from responses to five questions about food-related hardships experienced due to lack of money over the last four months: (1) food we bought didn't last, (2) couldn't afford balanced meals, (3) cut size or skipped meals, (4) ate less than felt needed, and (5) didn't eat for a whole day. Households with two or more responses of "yes," "often," or "sometimes" are classified as experiencing a *food insecurity hardship*.²⁹ While the data in Table 5 suggest that overall relatively few older American households experienced food hardships (4.7 percent), there are disparities in rates of food hardships among subpopulations of households distinguished by DB pension receipt. The rate of food hardships among older households without DB pension income (6.7 percent) is more than double that of their counterparts with DB pension income (2.6 percent).

Gender and race disparities in rates of food hardships are apparent in Table 5, but the data also show substantial reductions in these disparities among households receiving DB pension income. For example, the 1.5 percentage point gender disparity in the rate of food hardship (7.2 percent vs 5.7 percent) among households without DB pension income is more than halved (2.9 percent vs 2.3 percent) among households with DB pension income. The 8.6 percentage point Black-White racial disparity in the rate of food hardship (13.4 percent vs 4.8 percent) among households without DB pension income is nearly halved to 4.5 percentage points (6.4 percent vs 1.9 percent) among households with DB pension income. Lastly, while Table 5 expectedly shows much higher risks of food hardships among poorest households, within each income quartile rates of food hardships are considerably lower among households with DB pension income relative to those without such income.

Table 5 also displays rates of shelter expense and health care hardships in 2006. Households reporting that they were unable to pay the full amount of the rent or mortgage, or the full amount of gas, oil, electricity, or telephone utility bills, are classified as having experienced a *shelter expense hardship*. Although the vast majority of Americans 65 years and older are entitled under Medicare, most dental services and some medical expenses are not covered by Medicare and out-of-pocket costs for deductibles and co-payments can impose

a strain on household budgets. Households are defined as having experienced a *health care hardship* if they reported that in the past year one or more household members did not see a doctor or dentist when there was a need to see one. These data show that about 4.6 percent of older American households were unable to fully meet their regular expenses for shelter in 2006. In about 6 percent of households at least one member had to forgo a needed doctor or dental visit during the year. Rates of shelter and medical hardships were much lower among households with DB pension income relative to their counterparts without such income. Whereas only 2.4 percent of households with DB pension income experienced a shelter expense hardship in 2006, about 6.6 percent of households without DB pension income experienced such a hardship. Rates of shelter expense hardships were particularly low among households receiving public DB pension alone (1.7 percent) or both public and private DB pension income (1.6 percent). Similar to food hardships, there are fairly large gender and race disparities in rates of shelter and health care hardships that are attenuated within the subpopulation of households receiving DB pension income. The reduction of these gender and race disparities suggests that DB pension income has disproportionately helped older non-white and female-headed households to avoid these forms of material hardships.

Households with Pension Income Less Likely to Rely on Public Assistance

For many older American households with insufficient retirement income, particularly those unable to work or to find suitable employment, there may be few options other than to seek public assistance to help them meet their basic living needs. Table 6 shows that 10.9 percent of some 31.6 million American households with a head age 60 or older received an average of \$5,373 per household in means-tested cash transfers (e.g., Supplemental Security Income (SSI), general assistance) and/or noncash public assistance (e.g., food stamps, rent subsidies, energy assistance) in 2006. This is a conservative estimate of public assistance receipt since the SIPP definition of means-tested public assistance does not include expenditures made on behalf of Medicaid recipients.

The data in Table 6 suggest that households receiving DB pension income are much less reliant on public assistance transfers than households without pension income. Among households without DB pension income, 16.6 percent received public assistance in 2006. That was more than triple

Table 6: Percentage of Older Households Receiving Public Assistance and Amount of Assistance by DB Pension Income Status and Other Selected Characteristics, 2006

	Number of Households (millions) ^b	% Receiving Public Assistance	Mean Amount Received ^c	Median Amount Received ^c
All Households	31.6	10.9%	\$5,373	\$3,779
With Own or Spouse Pension Income	15.0	4.6%	\$4,558	\$2,976
No DB Pension Income	16.6	16.6%	\$5,578	\$3,890
Gender of Head of Household				
Male				
With Own or Spouse Pension Income	6.9	4.6%	\$4,760	\$3,519
No DB Pension Income	6.5	14.0%	\$6,156	\$5,063
Female				
With Own or Spouse Pension Income	8.1	4.6%	\$4,385	\$2,933
No DB Pension Income	10.0	18.3%	\$5,291	\$3,603
Race/Ethnicity				
Non-Hispanic White				
With Own or Spouse Pension Income	12.7	3.4%	\$4,653	\$2,520
No DB Pension Income	12.7	10.6%	\$5,172	\$2,873
Non-Hispanic Black				
With Own or Spouse Pension Income	1.3	12.0%	\$4,019	\$3,070
No DB Pension Income	1.8	36.0%	\$4,988	\$3,708
Other Race/Ethnicity				
With Own or Spouse Pension Income	1.0	9.8%	\$5,005	\$3,897
No DB Pension Income	2.0	36.6%	\$6,846	\$6,431
Household Income				
Lowest Quintile^a				
With Own or Spouse Pension Income	2.2	8.1%	\$2,358	\$1,344
No DB Pension Income	6.9	26.2%	\$4,397	\$3,006
Quintile 2				
With Own or Spouse Pension Income	4.6	5.0%	\$3,966	\$2,520
No DB Pension Income	4.2	12.3%	\$7,647	\$6,240
Quintile 3				
With Own or Spouse Pension Income	4.2	3.3%	\$6,468	\$4,800
No DB Pension Income	2.3	9.8%	\$8,010	\$6,431
Quintile 4				
With Own or Spouse Pension Income	2.6	3.9%	*	*
No DB Pension Income	1.7	8.8%	*	*
Highest Quintile				
With Own or Spouse Pension Income	1.4	3.2%	*	*
No DB Pension Income	1.4	3.1%	*	*

Source: Tabulations from the 2004-2006 Survey of Income and Program Participation, Core wave 7 and Topical Module 7.

Older households are defined as those whose head is age 60 or older.

a Quintile ranges are those reported by the U.S. Bureau of the Census for households with heads of all ages.

Quintile boundaries (lowest to highest) are: \$20,135; \$37,774; \$60,000; \$97,032.

b Totals may not add up due to rounding.

c All Dollars are in 2006 dollars.

the 4.6 percent rate for households with DB pension income. Furthermore, in 2006 public assistance recipients with DB pension received about \$1,020 less, on average, in cash and noncash transfer income than their public assistance recipient counterparts without DB pension income.

Table 6 also shows large gender and racial disparities in rates of public assistance receipt. Among households without DB pension income, non-White households are more than three times as likely to receive public assistance, as compared with White households (36-37 percent vs. 10.6 percent). The rate of public assistance receipt is a little higher among households without DB pension income headed by women (18.3 percent) relative to men (14 percent). But among households with DB pension income, there is no gender disparity. Although a racial

disparity remains in relative rates of public assistance among households with DB pension income, absolute differences between rates of public assistance receipt between nonwhite and white households (10-12 percent vs 3.4 percent) are greatly reduced. These latter results are consistent with the empirical literature on racial differences in participation rates in food stamp and federal welfare programs among households of all ages. Some racial disparities in participation rates generally persist after adjustments are made for need factors affecting welfare participation.³⁰ The reasons for these racial disparities are not fully understood. They have been attributed to lower take up rates among eligible whites due to factors such as inadequate information about programs and eligibility requirements, perceived high costs of participation and lack of need, as well as stigma against use of public assistance.³¹

THE PENSION FACTOR: ISOLATING THE IMPACT OF PENSION INCOME ON ELDER WELL-BEING

The descriptive statistics presented suggest that older households with DB pension income fare much better than households without such income on several indicators of economic welfare.

Relative to households without DB pension income, households with DB pension income are less likely to be classified as poor or near-poor (Table 4), less likely to experience material hardships associated with food consumption, shelter expenses, and foregone medical and dental care (Table 5), and are less likely to rely on means-tested public assistance (Table 6). We now will attempt to quantify these impacts by developing estimates of how many households were able to escape poverty and avoid material hardships as a consequence of their DB pension income. In addition we estimate government savings in the form of reduced public assistance expenditures associated with DB pension income receipt by older households. In order to provide some perspective on the magnitude of these estimated impacts of DB pension income receipt, we develop similar estimates of the impacts of DC and Social Security income receipt.

The estimated impacts of DB, DC, and Social Security income receipt were computed from predictions derived from household-level binary logit or multinomial logit (MNL) models for each of the economic welfare outcomes contained in Tables 4 through 6 — incidence of poverty, hardships, and public assistance receipt. These models enable us to isolate the effect of DB pension receipt on the probability of suffering an adverse outcome. Each statistical model includes a set of “control variables” — household characteristics that, in theory, should also affect the probability that a household will experience the adverse outcome. For example, consider the outcome of a shelter hardship. In order to estimate the effect of DB pension receipt on the probability that a household will experience a shelter hardship, we must control for differences in the education, age, gender, marital status, and race of heads of household, because the risk of experiencing a shelter hardship will be higher or lower depending on these attributes. For

example, a household headed by a better-educated, married, white male may be expected to have a more continuous work history, higher earnings, and greater wealth accumulation than a household headed by a lesser-educated, divorced, Black woman. Since the male should also be more likely to have worked in a job with a DB pension benefit, such potential confounding variables must be specified in statistical model of the risk of shelter hardship. Otherwise, we may erroneously attribute the effects of factors such as higher education, male gender, or race to an effect of DB pension receipt. In each statistical model the probability of experiencing an adverse outcome was specified to be a function of socio-demographic attributes of the household and its head. Depending on the specification, these attributes included age, gender, race, marital status, education level, household size, foreign born, geographic location factors (region and metropolitan residence), employment status (hours worked), and indicators of whether or not one receives DB pension income, DC income, and Social Security income, as well as work history and pre-retirement income.

The estimated coefficients from these statistical models can be used to generate predicted probabilities that households with different characteristics (like those mentioned above) will experience each poverty and material hardship outcome. The coefficient for any particular factor specified in the model, such as DB pension receipt, reflects the independent contribution of that factor to these estimated probabilities after all of the other factors are taken account of. For example, consider two households that have identical socio-demographic and economic attributes and who live in the same geographic region. Neither household receives DC income and both receive some Social Security income. The households differ only in that one of them receives some DB pension income and the other does not. The estimated coefficient for the DB pension receipt variable in the statistical models allows us to estimate how much the probability of each hardship outcome will differ for these two, otherwise identical, households. By extension, these coefficients can also be used to estimate for how much the probability of hardship and poverty outcomes are expected to change, on average, for each household with DB pension income in the sample data if they had not received any DB pension income.

The estimated coefficients from the statistical models were used to generate national predictions of the number of households that would have experienced each adverse outcome, such as a shelter hardship, if no households received any DB pension income. The difference between this adjusted estimate and the national estimate of households actually experiencing the outcome produces a national estimate of the number of households that were able to avoid the adverse economic welfare outcome because of their receipt of DB pension income. Additional details about the analytic strategy, model estimation, and sensitivity analyses conducted to test the robustness of the empirical results can be found in the Technical Appendix.³²

Pensions Help 4.7 Million Americans Avoid Poverty

Table 7 presents national estimates of the impacts of DB pension, DC, and Social Security income on the poverty status of households with a head age 60 or older in 2006. The estimates were derived by employing predicted values from a MNL model which predicted the likelihood of a household being poor, near-poor, or not-poor, based on its socio-demographic characteristics.³³ The estimates suggest that about 4.7 million older households would be added to the count of poor or near-poor households if not for their receipt of DB pension income. An estimated 1.6 million additional households would be similarly re-classified from their not-poor poverty status if not for their receipt of Social Security income. About 90,000 not-poor households would be reclassified as near-poor or poor without their receipt of DC income. The very low rate of DC income receipt relative to DB and Social Security income receipt among older households (see Table 3) certainly contributes to these modest estimated impacts. However, the low rate of DC income receipt is unlikely to fully account for its modest impact. Although nearly twice as many older households received Social Security income than DB income in 2006 (76 percent vs 39 percent), 1.2 million more households are estimated to escape poverty or near-poverty status due to DB income receipt than to Social Security income receipt. However, it is notable that Social Security income receipt appears to protect more older households than does DB pension receipt from more extreme poverty defined solely by the FPL (2.9 million vs 1.7 million). In other words, Social Security is highly effective at helping seniors avoid poverty, but DB pensions enable people to maintain a middle-class standard of living in retirement.

Table 7: Impact of DB, DC and Social Security Income on Older Households' Poverty Level Classifications, 2006

	Number of Poor/ Near-/Not Poor Households (millions)	Net Change in Poor/Near-/Not Poor Households (millions) ^b	% change
Poor Households			
Actual SIPP National Estimate	2.85		
Without DB Pension Income Receipt ^a		1.72	60.4%
Without DC Income Receipt		0.03	1.1%
Without Social Security Income Receipt		2.95	103.5%
Near-Poor Households			
Actual SIPP National Estimate	8.04		
Without DB Pension Income Receipt ^a		2.97	36.9%
Without DC Income Receipt		0.06	0.7%
Without Social Security Income Receipt		-1.30	-16.2%
Not-Poor Households			
Actual SIPP National Estimate	20.68		
Without DB Pension Income Receipt ^a		-4.69	-22.7%
Without DC Income Receipt		-0.09	-0.4%
Without Social Security Income Receipt		-1.64	-7.9%

Source: Analysis conducted on 2004-2006 Survey of Income and Program Participation. Core wave 7, Topical Modules 7 and 8. Older households are defined as those whose head is age 60 or older.

a Results derived from estimated multinomial logit models with dummy variables for DB, DC, and Social Security receipt set to zero, respectively. For details see Technical Appendix.

b Poor: (Income \leq FPL), Near-Poor: (FPL < Income \leq 200% FPL), Not-Poor: (Income > 200% FPL)

Pensions Substantially Reduce Material Hardships

Table 8 contains estimates of the impacts of DB, DC, and Social Security income receipt on the material hardships experienced by older American households. We estimate that more than a half-million additional older households would have experienced food hardships in 2006 if it were not for their DB pension income. While this impact may appear to be modest, it would reflect nearly a 23 percent increase in older households experiencing food hardships, and it is considerably larger than the estimated impacts of DC income receipt. Interestingly, Social Security income receipt was not associated with the risk of food hardships when other factors affecting the risk of food hardships were statistically accounted for.³⁴

Without their DB pension income, we estimate that about 380,000 additional older households would have experienced a shelter hardship in 2006, a 26 percent increase over the actual estimated 1.45 million older households with shelter hardships that year. The estimated impacts of both DC income and Social Security income were far more modest, ranging between 30-40,000 additional households experiencing shelter hardships. We also estimate that additional 320,000 additional households with a head age 60 or older would have experienced a health care hardship in 2006 without their receipt of DB pension income, a 16.5 percent increase over the actual national estimate of 1.9 million older households for that year. Similar to what was found for food hardships, Social Security income receipt was not associated with health care hardships, and estimated impacts of DC income receipt were far more modest than those of DB pension receipt.

Table 8: Impact of DB, DC and Social Security Income on Older Households' Experience of Material Hardships and/or Receipt of Public Assistance, 2006

	Number of Households Experiencing Hardship or Receiving Public Assistance (millions)	Increase in Number of Households with Hardship or Public Assistance (millions)	% change	Aggregate Public Assistance Expenditures (\$ billions)	Increase in Public Assistance Expenditures Hardships (\$ billions)	% change
Public Assistance Receipt						
Actual National SIPP Estimate 2006	3.43			\$18.4		
Without DB Pension Income Receipt		1.35	39.3%		\$7.3	39.3%
Without DC Income Receipt		0.07	2.1%		\$0.4	2.1%
Without SS Income Receipt		1.88	54.8%		\$10.1	54.8%
Food Hardship						
Actual National SIPP Estimate 2006	2.44					
Without DB Pension Income Receipt ^a		0.56	22.8%			
Without DC Income Receipt		0.07	2.7%			
Without SS Income Receipt		0.00	0.0%			
Shelter Hardship						
Actual National SIPP Estimate 2006	1.45					
Without DB Pension Income Receipt		0.38	26.2%			
Without DC Income Receipt		0.04	2.5%			
Without SS Income Receipt		0.03	2.3%			
Health Care Hardship						
Actual National SIPP Estimate 2006	1.91					
Without DB Pension Income Receipt		0.32	16.8%			
Without DC Income Receipt		0.06	3.2%			
Without SS Income Receipt		0.00	0.0%			

Source: Analysis conducted on 2004-2006 Survey of Income and Program Participation, Core wave 7, Topical Modules 7 and 8. Older households are defined as those whose head is age 60 or older.

a Results are derived from binary logit model with dummy variables indicating DB, DC, or Social Security receipt set to zero, respectively. For details see Technical Appendix.

Pensions Keep 1.4 million Americans Off Public Assistance

Lastly, Table 8 also contains national estimates of the impact of DB, DC, and Social Security income receipt upon older households' receipt of means-tested public assistance. We estimate that without their receipt of DB pension income, an additional 1.4 million older American households would be added to the rolls of public assistance recipients in 2006. This represents nearly a 40 percent increase over the 3.4 million older households receiving public assistance in 2006. While a very modest impact was found for DC income receipt, the greatest estimated impacts were associated with Social Security income receipt. We project that an additional 1.9 million older households would place demands on public assistance benefits

if not for their receipt of Social Security income. Employing the mean dollar amount of \$5,373 received by all older households with public assistance in 2006, we estimate that DB pension income and Social Security income receipt reduced claims on governmental public assistance from older households in 2006 by about \$7.3 billion dollars and \$10.1 billion dollars, respectively. These impacts are large, particularly when it is considered that Medicaid expenditures are not included as public assistance in the SIPP data. While our estimates of savings associated with DB pension income are modest in comparison to aggregate total national expenditures by federal, state, and local governments, they represent about 8.5 percent of aggregate public assistance dollars received by all American households in 2006 for the same benefit programs.³⁵

CONCLUSION

This study provides an empirical analysis of the contribution of DB pensions to the economic security of older American households. Our findings suggest that DB pension income plays a vital role in reducing the risk of poverty and material hardships among older households.

In 2006 rates of poverty among older households without DB pension income were approximately six times greater than the rate among older households with DB pension income. Older households with DB pension income were also less likely to experience food, shelter, and health care hardships. In addition, DB pension recipient households were less reliant on means-tested cash and noncash public assistance. While DB pension recipient households fared better than households without pension income generally, DB pensions appear to have particularly improved the welfare of more vulnerable subpopulations of elder households. Our analysis indicates that common gender and racial disparities in rates of poverty, material hardships, and dependence on public assistance are greatly diminished, and in some cases nearly eliminated, among households receiving DB pension income.

Quantification of some of the economic welfare benefits associated with DB pensions brings some tangible data supporting the premise that DB pensions enhance the chances that older Americans can be self-sufficient after retirement from the workforce. Our analyses suggest that DB pension income has helped substantial numbers of older American households to avoid material hardships associated with inadequate food, shelter, and health care. More specifically, we estimate that in 2006, DB pension receipt among older American households was associated with:

- 1.72 million fewer poor households and 2.97 million fewer near-poor households
- 560,000 fewer households experiencing a food hardship
- 380,000 fewer households experiencing a shelter hardship
- 320,000 fewer households experiencing a health care hardship
- 1.35 million fewer households receiving means-tested public assistance

Furthermore, not counting Medicaid reimbursements for acute and long-term medical care, we estimate that in 2006 there was about a \$7.3 billion savings in public assistance expenditure associated with DB pension receipt. This represents about 8.5 percent of aggregate public assistance dollars received by all American households in 2006 for the same benefit programs. This amount is significant, particularly given the pressures on safety net programs during the current fiscal crises experienced at all levels of government throughout the country.

While our empirical findings suggest that the impacts of DB pension income on the economic security of older American households are sizeable, they may only scratch the surface in measuring the full magnitude of social welfare benefits. It is well known that health and economic welfare are integrally related, particularly among the elderly. The reduced risks of

poverty, food, shelter, and health care hardships among elder households stemming from the greater economic security associated with DB pension should also produce favorable impacts on the health of older Americans. Having a healthy diet with regular meals, ample heat in one's home in cold weather, and sufficient resources to seek medical care when needed should help older persons to better maintain their health and functional status as they advance in age. This should generate additional societal benefits from reduced demands on acute and long-term care resources over the long run. Although it was beyond the scope of this study to examine such secondary impacts of DB pensions, our study findings nevertheless underscore the vital role that both DB pension and Social Security income play in securing the economic welfare of older American households.

REFERENCES AND NOTES

- 1 U.S. Bureau of Labor Statistics. 2008. National Compensation Survey: Employee Benefits in the United States, March 2008. Bulletin 2715. Washington, DC: U.S. Department of Labor.
- 2 Some workers with DB pensions have also been adversely affected by recent financial turmoil. Investment losses have led some private employers and governments to freeze DB plans. Simulation analyses by Butrica, Iams, Smith, and Toder (2009). *The Disappearing Defined Benefit Pension and its Potential Impact on the Retirement Incomes of Boomers*. Discussion Paper 09-01. The Retirement Policy Program. Washington, DC: The Urban Institute), conducted prior to the recent market turmoil, suggest that DB plan freezes produce more losers than winners, and relative losses are greatest among workers with mid-level job tenure and wages. Also, private sector workers whose employers become insolvent may experience some reductions in expected pension benefits if the plan is terminated. Benefits may be at risk if they exceed the insurance limits of the federal pension guarantee program, which currently stands at \$4,500 per month for a worker retiring at age 65.
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- 4 Ghilarducci, T. 2006. *Future Retirement Income Security Needs Defined Benefit Pensions*. Washington, DC: Center for American Progress; and Purcell, P. 2008. *Income and Poverty among Older Americans in 2007*. CRS Report for Congress RL32697. Washington, DC: Congressional Research Service.
- 5 Purcell, P. 2008. *Income and Poverty among Older Americans in 2007*. CRS Report for Congress RL32697. Washington, DC: Congressional Research Service.
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- 7 For a summary of SIPP content and its history see: U.S. Bureau of the Census. 2006. *Introduction to the Survey of Income and Program Participation*. Washington, DC: U.S. Bureau of the Census.
- 8 Since the Pension and Adult Well-Being module surveys were conducted at different interviews individuals there is some modest sample attrition between these surveys. Population weights from the later topical module were employed in all analyses after adjustments were made to compensate for sample attrition.
- 9 Such as Copeland, C. 2007. Pension income of the elderly and characteristics of their former employers. *EBRI Notes*, 28(3), 2-7.
- 10 Our estimated DB pension rates for 1998 and 2003 are lower than those reported by Copeland (2007) from SIPP data for persons age 65 years and older. The differences between our estimates of pension receipt from one's own former employer and those of Copeland (2007) are entirely explained by our lower minimum age of 60. We obtained the same prevalence rates for 1998 and 2003 as Copeland (2007) when the same age restrictions were employed. Our 2006 estimate is lower than the 34.7 percent reported by Purcell (2008) for persons 65 years and older from 2007 Current Population Survey (CPS) data. While different age ranges should also explain some of the difference, there may be additional residual differences due differences in survey design, data collection, and the timings of the surveys.

- 11 These married couples include those where both persons receive DB pension income from their own former employers, and those where one person receives DB from his/her former employer and the other person receives survivor DB pension income. About 44 percent of households in the 2006 SIPP study sample were married couples. Since about 55 percent of these married couples both persons received some DB pension, dual-recipient households comprise only 22 percent of all households in the SIPP sample in 2006. While the mean total annual pension income received by dual-recipient households was about 60 percent larger than that of households with only one pension recipient in 2006, the data in Table 1 are for older persons rather than households. Both persons of a married couple are counted separately in these data if they are at least 60 years old and their combined DB pension income is assigned to both persons of a married couple.
- 12 Munnell, A.H., and Perun, P. 2006. *An Update on Private Pensions*. Issue in Brief 50. Chestnut Hill, MA: Center for Retirement Research at Boston College; and Poterba, J., Venti, S., and Wise, S. 2007. *The Decline of Defined Benefit Retirement Plans and Asset Flows*. Working Paper 12834. Cambridge, MA: The National Bureau of Economic Research.
- 13 Similar tabulations to those reported in Table 2 through Table 7 were made with SIPP data for 1998 and 2003. Since there were no remarkable differences between the patterns found in these years relative to 2006, only the 2006 results are reported.
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- 20 Ghilarducci, T. 2006. *Future Retirement Income Security Needs Defined Benefit Pensions*. Washington, DC: Center for American Progress; and Poterba, J., Venti, S., and Wise, S. 2007. *The Changing Landscape of Pensions in the United States*. Working Paper 13381. Cambridge, MA: The National Bureau of Economic Research.
- 21 It is important to note here that DB, DC, and Social Security income receipt are not mutually exclusive. Many households receive income from two of these sources, and some receive income from all three sources. The mean and median amounts are based on the subset of households receiving that type of income regardless of whether they receive income from the other sources.
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- 23 Citro, C.F., and Michael, T.F., eds. 1995. *Measuring Poverty: A New Approach*. Washington, DC: National Academy Press; and Ouellette, T., Burstein N., Long, D., and Beecroft, E. 2004. *Measures of Material Hardship: Final Report*. Washington DC: U.S. Department of Health and Human Services, Office of the Assistant Secretary for Planning and Evaluation.
- 24 An obvious potential shortcoming of material hardship measures is their subjectivity since individual preferences can affect what individuals perceive as basic life necessities. There is no universally accepted standard for what constitute a hardship (See Ouellette, Burstein, Long, and Beecroft 2004).
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- 26 Purcell, P. 2008. *Income and Poverty among Older Americans in 2007*. CRS Report for Congress RL32697. Washington, DC: Congressional Research Service.
- 27 Beverly, S.G. 2001. Material hardship in the United States: Evidence from the Survey of Income and Program Participation. *Social Work Research*, 25(3), 143-151; Ouellette, T., Burstein N., Long, D., and Beecroft, E. 2004. *Measures of Material Hardship: Final Report*. Washington DC: U.S. Department of Health and Human Services, Office of the Assistant Secretary for Planning and Evaluation; Rector, R., Johnson, K., and Youssef, S. 1999. The extent of material hardship and poverty in the United States. *Review of Social Economy*, LVII(3), 351-385; and She, P., and Livermore, G.A. 2007. Material hardship, poverty, and disability among working-age adults. *Social Science Quarterly*, 88(4), 970-989. In particular, Ouellette, Burstein, Long, and Beecroft (2004) conducted a very thorough analysis of various hardship measures using data from the 1996 SIPP Adult Well-Being Topical Module. Durable good hardships (i.e., lack of a refrigerator or stove) were found to be very rare and can only identify the neediest households. Very weak associations were also found between housing safety and overcrowding hardship variables (e.g., holes in walls and/or floors, leaking roof or ceiling, broken window glass, problems with pests) and household income levels. After drawing similar conclusions in our own preliminary analyses of 2004 SIPP data, we did not analyze housing condition hardship measures.

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- 33 We also computed impacts simply by subtracting a household’s actual reported DB, DC, or Social Security income from reported total household income to obtain adjusted household incomes that were then compared to the federal poverty line for the household. These estimates differ from the statistical estimates because the simple subtraction of a component of household income takes no account of potential systematic differences in the characteristics of households receiving DB, DC, or Social Security income. While both approaches produced similar national estimates of the impacts of DB and DC income, the estimated impacts for Social Security income receipt were much larger when Social Security income was simply subtracted from household income. In contrast to our MNL model projection of 2.95 million additional poor older households, an additional 10.6 million poor households are added when Social Security income was simply subtracted from household income. The latter result appears implausibly large given the similarity in the projections for DB and DC income receipt when both methods were used.
- 34 Not only was the estimated coefficient for the Social Security income receipt dummy variable not statistically significant, but the actual estimated coefficient was nearly zero as well.
- 35 Employing the same methodology, we estimated that households of all ages received about \$85.6 billion from mean-tested public assistance programs in 2006.

TECHNICAL APPENDIX

Analytic File Construction

For each of the 1996, 2001, and 2004 SIPP panel files, the information needed to conduct the descriptive and multivariate analyses was contained in a Core Wave data file and two topical modules. The Retirement and Pension Plan Coverage Topical Module (Topical module 7 in all panels) served as main file for construction of the analytic research file for each SIPP panel. The Core file for Wave 7 containing the same reference month as Topical module 7 was selected and merged to the Pension topical module. Since the topical module and core data files had the same reference month, all cases were matched in the file merger. The material hardship variables were contained in the SIPP Adult Well-Being Topical Module. These data were contained in Topical Module 8 in the 1996 and 2001 SIPP panels and in Topical Module 5 of the 2004 SIPP panel. Since the reference month of the Topical module differed from that of Topical module 7, a complete one-to-one match of respondents cannot be attained because of changes in the sample due to attrition and the addition of new household members over time in SIPP panel data. The final analysis file for each SIPP panel consisted of the subset of respondents with records in both the Pension and Adult Well-Being Topical modules. The population weights from the Pension Topical module of respondents in the final analytic file were adjusted upward to compensate for the sample attrition resulting from merger of the Adult Well-Being Topical Module.

Study Populations

In the descriptive analyses persons include *all* respondents age 60 years or older and households include all respondents who are a head of household. Person attributes, such as age, gender, and race associated with households are those of the head of the household.

Defined Benefit Pension Status and Income

Receipt of a defined benefit (DB) pension is defined here as receiving pension income from a former employer in the reference month associated with retirement, disability, or survivorship, and lasting for the remainder of one's life. Similar to past research using SIPP data (Copeland, 2007), payments from Social Security, withdrawals from IRA, Keogh and 401K plans, and lump sum pension distributions are not counted as DB pension income. Pension receipt for *persons* is measured in two ways: (1) pension income received from one's own former employer only, and (2) pension income received from both one's own former employer *and/or* from the former employer of a current or decedent spouse. While public and private source of DB pension income cannot be distinguished in the SIPP Retirement and Pension Plan Coverage Topical Module, pension income sources are reported in SIPP Core Interview Waves. Accordingly pension receipt and amounts were determined using information from both the topical module and core wave data files corresponding to the same reference month. Pension income receipt and amounts from the former employer of a spouse/partner were determined in two steps. Since persons age 60 or older may have spouses younger than 60 years old, a separate file containing pension income variables pertaining to one's own former employer, was first created for all SIPP respondents at least 20 years old. The spouse person identifier variable contained from the SIPP core file was then used to merge spousal records with pension variables to all SIPP respondents 60 years old or older. Pension receipt for *households* includes pension income received from *both* the head of household's own former employer *and/or* from the former employer of a spouse.

Annual pension income was estimated by inflating amounts reported for the reference month by a factor of 12. Annualized pension income amounts were then inflated or deflated to constant dollars for January 2003 using the Bureau of Labor Statistics Consumer Price Index (CPI) of the reference month and year (<ftp://ftp.bls.gov/pub/special.requests/cpi/cpiat.txt>).

Public versus Private Pension Income

SIPP Core Interview data distinguish among seven types of DB pension income. Public pensions include: (1) Federal Civil Service or other Federal civilian employee pension, (2) U.S. military retirement, (3) state government, (4) local government, and (5) Railroad Retirement Board. Private pensions include: (1) company or union pension, and (2) other nongovernment retirement pensions.

Annual Household Income Quintiles

Annual household income was estimated by inflating the amount reported for the reference month by a factor of 12. Household income quintiles pertain to households with heads of any age as reported in *Historical Income Tables-Households*, U.S. Bureau of the Census (<http://www.census.gov/hhes/www/income/histinc/h01ar.html>), for the calendar year corresponding to the SIPP data reference month and year. The quintile definitions for 1998 are: (below \$16,116) (\$16,116-\$30,408) (\$30,408-\$48,337) (\$48,337-\$75,000) (\$75,000 and above). The quintile definitions for 2003 are: (below \$17,984) (\$17,984-\$34,000) (\$34,000-\$54,453) (\$54,453-\$86,867) (\$86,867 and above). The quintile definitions for 2006 are: (below \$20,035) (\$20,035-\$37,774) (\$37,774-\$60,000) (\$60,000-\$97,032) (\$97,032 and above).

Poverty Class

The SIPP contains a household-level variable containing the dollar amount for the U.S. Bureau of the Census poverty threshold or FPL associated with the respondent household. This threshold is based on household size, age of the head of household (65 years and older versus under 65 years), and number of related children under 18 years old. This variable was used to classify into one of three poverty level classes: (1) *poor* at or below the FPL, (2) *near poor* above the FPL but at or below 200% of the FPL, and (3) *not poor* more than 200% of the FPL.

Material Hardship Measures

We constructed three material hardship measures from SIPP Adult Well-Being Topical Modules similar to the most frequently used material hardship measures in previous research. These include hardships related to: inability to meet basic living expenses, inadequate food consumption, and unmet medical or dental needs. A household is classified as having a *shelter hardship* if it reported that it experienced at least one of the following five hardships in the previous year: (1) did not pay the full amount of the rent or mortgage, (2) was evicted from one's home or apartment for not paying the rent or mortgage, (3) did not pay the full amount of the gas, oil, or electricity bills, (4) gas or electric company turned off service, or the oil company did not deliver oil because of payment problems, and (5) the telephone company disconnected service because payments were not made. *Food hardships* were based on the three-point food security scale of the U.S. Department of Agriculture (She & Livermore, 2007). The scale is based on a count of responses of yes, sometimes, or often to five questions about food-related hardships experienced over the last four months because there was not enough money: (1) food we bought didn't last, (2) couldn't afford balanced meals, (3) cut size or skipped meals, (4) ate less than felt needed, and (5) didn't eat for a whole day. A household is classified as "food insecure with hunger" with a count of 4-5 positive responses, "food insecure without hunger" with 2-3 positive responses, and "food secure" with one or no positive responses. The two food insecurity categories were combined into a single category in our dichotomous measure of food hardships. A household is classified as having a *health care hardship* if it reported that in the previous year a household member needed to see a doctor or dentist but did not go.

Public Assistance Receipt and Amounts

The SIPP contains information about various types of cash and noncash forms of public assistance received by households, as well as the aggregated amount of cash and noncash assistance received. A binary variable indicating the receipt of cash and/or noncash

public assistance receipt was created from two constructed SIPP variables: *THTRNINC*, an aggregated total of household means-tested cash transfers for reference month, and *THNONCSH*, an aggregated total dollar value of noncash public assistance for the reference month. Means-tested cash assistance includes Supplemental Security Income (SSI), Temporary Assistance for Needy Families (TANF) and general assistance. Noncash public assistance includes Women, Infants, and Children Nutrition Program (WIC), food stamps, and energy assistance. While the SIPP contains information about Medicaid eligibility, it is not counted here as public assistance because the SIPP does not have information on dollar amounts of Medicaid reimbursements. The annual dollar amount of public assistance received was computed as the sum of cash and noncash public assistance in the reference month inflated by a factor of 12. Annualized pension income amounts were then inflated or deflated to constant dollars for January 2003 with the CPI of the reference month and year.

Given the relatively low prevalence rate of households receiving public assistance, the sample sizes for some household subgroups in Table 6 are too small to produce reliable estimates of public assistance dollar amounts. More specifically, amounts of public assistance are not reported when either: the sample size for each subgroups was less than 100 respondent households, or when the sample size of one subgroup was less than 30, regardless of the sample size for the other subgroup(s).

Multivariate Analyses

The 2004 SIPP panel data were employed in the multivariate analysis. We report the results on models estimated on a sample of 10,259 households with a head age 60 years and older.

Model Specification

Models were specified for four binary and one categorical dependent variable:

Public assistance	1=household receipt of cash and/or noncash assistance, 0=otherwise
Food hardship	1=household classified with a food insecurity with or without hunger under USDA scale, 0=otherwise
Health care hardship	1=household reports forgoing medical and/or dental services=1. 0=otherwise
Financial hardship	1= household reports one or more of 5 potential hardships associated with making ends meet. 0=otherwise.
Poverty status	1= poor, 2=near-poor, 3=not-poor.

Logistic regression models were first estimated for the four binary dependent variables defined above. A multinomial logit model was used to estimate the model with the categorical dependent variable of poverty status because the proportional odds assumption underlying an ordinal logit model specification were not supported by statistical tests. Observations were weighted by normalized population weights and the standard errors of coefficients were adjusted for the complex survey design of the SIPP by use of the *svylogit* procedure in Stata V10.0.

The key independent variables of interest in all of the models are the receipt of DB pension income, defined contribution (DC) contribution income, and Social Security (SS) income. These variables specified as dummy variables indicating the receipt of such income by the head of household and/or spouse. Based on availability in the SIPP data, additional variables were specified to account for other socio-demographic factors that should affect the poverty status, public assistance receipt, and material hardships among older households. These variables are defined in Table A.1. Several variables were only available for household heads that reported to have retired from a job or business in the past. These variables were only specified in the models used as part of sensitivity analyses of the empirical results obtained from the models estimated on the full sample of 10,259 older households.

Table A-1: Definitions of Independent Variables

Variable Name	Definition
DB pension receipt	1=head of household and/or spouse received DB pension income 0=no
DC income receipt	1=head of household and/or spouse received DC income, 0=no
SS income receipt	1=head of household and/or spouse received SS income, 0=no
Current hours worked per week	Hours worked per week in current employment
Age	Age in years
Born outside of US	1= born outside of the U.S., 0=born in U.S.
8 or fewer years of school completed	1= 8 or fewer years of schooling completed, 0=otherwise
9-11 years of school	1=9-11 years of schooling completed, 0=otherwise
High school graduate or GED	1=high school graduate with 12 years or school completed or GED, 0=otherwise
1-3 years of college	1=1-3 years of college completed, 0=otherwise
4+ years of college (omitted reference group)	1= 4 or more years of college completed, 0=otherwise
Male	1=male, 0=female
Widowed	1=widowed, 0=otherwise
Divorced or separated	1=currently divorced or separated, 0=otherwise
Never married	1= never married, 0= otherwise
Married (omitted reference group)	1= married, 0=otherwise
NonHispanic Black	1= nonHispanic Black, 0=otherwise
Hispanic	1= Hispanic, 0=otherwise
Other Race	1=Other race, 0=otherwise
NonHispanic White (omitted reference group)	1- nonHispanic White, 0=otherwise
Household members	Count of household members
Midwest	1= residence in Midwest Census Region, 0=otherwise
South	1= residence in South Census Region, 0=otherwise
West	1= residence in West Census Region, 0=otherwise
Northeast (omitted reference group)	1= residence in Northeast Census Region, 0=otherwise
Metropolitan area residence	1= metropolitan residence, 0=otherwise
Annual preretirement household income ^a	Annual earnings from job or business prior to retirement in \$1,000s
Years since retirement from job ^a	Years since retirement from job or business
Years worked at pre-retirement job ^a	Years worked at job retired from
Pretirement union member ^b	1= union member in pre-retirement job, 0=otherwise

a This variable was only specified in the models estimated on subsample of ever-retired households.

b This variable was only specified in the instrumental variable model estimated on subsample of ever-retired households.

Table A-2: Unweighted Sample means (n=10,259)

Variables	Mean	SD
DB pension receipt	0.39	0.49
DC income receipt	0.06	0.25
SS income receipt	0.79	0.40
Current hours worked per week	7.59	16.68
Age	71.79	8.01
Born outside of US	0.07	0.26
8 or fewer years of school completed	0.08	0.27
9-11 years of school	0.07	0.25
High school graduate or GED	0.36	0.48
1-3 years of college	0.29	0.46
Male	0.41	0.49
Widowed	0.34	0.48
Divorced or separated	0.16	0.37
Never married	0.02	0.13
NonHispanic Black	0.12	0.32
Hispanic	0.04	0.19
Other Race	0.04	0.18
Household members	1.76	0.94
Midwest	0.26	0.44
South	0.39	0.49
West	0.18	0.38
Metropolitan area residence	0.72	0.45

Sensitivity Analyses

Since the statistical models are used to estimate the effects of DB, DC, and SS income receipt on adverse outcomes the models should be fully-specified as possible so that effects of other variables are not erroneously attributed to DB, DC, or SS income receipt. Unfortunately the SIPP does not contain information on lifetime earnings and wealth of households. However, the SIPP has some information about work history for individuals who retired from a job or business in the past that were not available for specification of covariates in the models estimated on the full sample of older households. These variables were: pre-retirement annual household income, years worked at pre-retirement job, and years since retirement. The models were re-estimated on the subsample of 5,086 households with a head age 60 years and older who reported that they had retired from a job or business. This allowed us to compare the results of models estimated with and without a richer set of factors affecting poverty status, material hardships, and public assistance for the subsample of ever-retired households. The most notable differences between the estimates for the subsample when the pre-retirement job variables were added were the education dummy variables and only a very modest improvement in model fit. The changes suggested that the effects of pre-retirement work variables on adverse welfare outcome variables were largely captured by the specification of education variables.

Concerns may also be raised about the potential endogeneity problems in the specification of dummy variables for DB, DC, and SS income receipt since persons may self-select employment in jobs with DB pension or DC plans. We attempted to address this concern by re-estimating the models with a two-step probit model instrumental variable estimation procedure (*ivprobit*) where a model of

DB pension receipt is estimated first, and then predicted values from this model are used as instruments replacing the observed DB pension variables in the second-step model of public assistance or hardship outcome. While some caution should always be exercised in making predictions from estimated models, these models did not suggest that selection bias to be a serious problem.

Table A-3: Multinomial Logit Model Results for Poverty Class (n=10,259)

Variables	Poor relative to Not-Poor		Near-Poor relative to Not-Poor	
	Odds Ratio	p-value	Odds Ratio	p-value
DB pension receipt	0.09	0.000	0.27	0.000
DC income receipt	0.65	0.108	0.77	0.043
SS income receipt	0.28	0.000	0.96	0.707
Current hours worked per week	0.94	0.000	0.96	0.000
Age	1.00	0.920	1.02	0.000
Born outside of US	1.58	0.007	1.58	0.000
8 or fewer years of school completed	5.90	0.000	7.45	0.000
9-11 years of school	4.73	0.000	5.46	0.000
High school graduate or GED	2.28	0.000	3.68	0.000
1-3 years of college	1.79	0.000	2.63	0.000
Male	0.84	0.035	0.88	0.035
Widowed	0.78	0.050	1.37	0.001
Divorced or separated	1.59	0.001	1.84	0.000
Never married	1.03	0.932	0.97	0.919
NonHispanic Black	3.40	0.000	1.77	0.000
Hispanic	1.76	0.006	1.48	0.016
Other Race	3.11	0.000	1.45	0.031
Household members	0.62	0.000	0.70	0.000
Midwest	0.86	0.329	0.91	0.288
South	1.05	0.699	1.08	0.372
West	0.69	0.028	0.93	0.417
Metropolitan area residence	1.13	0.184	1.09	0.069
Pseudo- R square	0.21			

Estimating of the Impacts of DB, DC, and SS Income Receipt on Welfare Outcomes

After estimating the coefficients for the models described above, we derived estimates of the additional older households that would have experienced the various adverse welfare outcome if it were not for their receipt of DB pension, DC income, and SS income. The estimation approach is described below for receipt of DB pension income and public assistance receipt. The same approach was used for other adverse welfare outcomes, and for estimating the impacts of DC and SS income receipt

1. Predicted values were obtained from the estimated model with actual values for DB pension receipt. These predicted values were multiplied by SIPP population weights and summed to obtain a national estimate of the number of households with DB pensions receiving public assistance.

2. A second set of predicted values were then obtained. For these predictions, the DB pension receipt variable was set to zero for all households with DB pensions rather than their actual value of one. These predicted values were then multiplied by SIPP population weights and summed to obtain a national estimate of the number of households that would be expected to receive public assistance if no households had DB pension income.
3. Since DB pension receipt was negatively associated with public assistance receipt, the difference between these two predicted values is the national estimate of the additional number of households that would be expected to receive public assistance in the absence of DB pension income receipt.

The dollar impact of DB pension receipt of public assistance expenditures was obtained by multiplying the estimate of households from step 3 by the mean annual amount of public assistance received by older households in 2006 from the study data, or \$5,373.

Table A-4: Logistic Regression Results

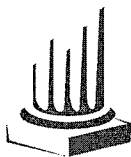
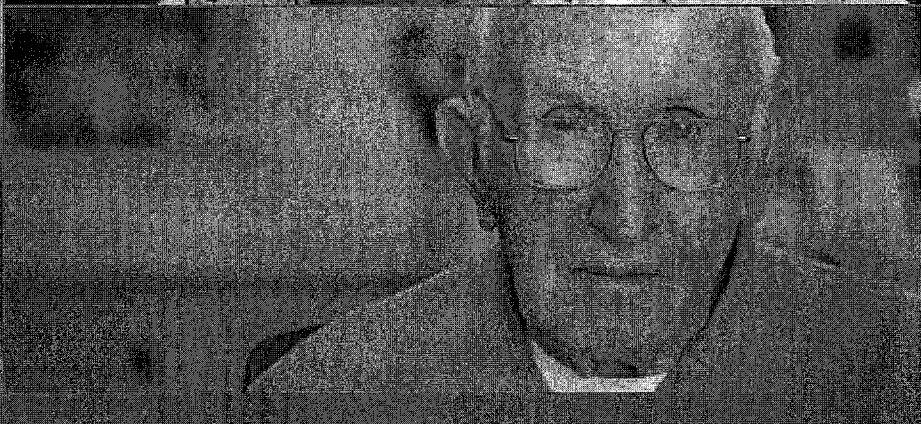
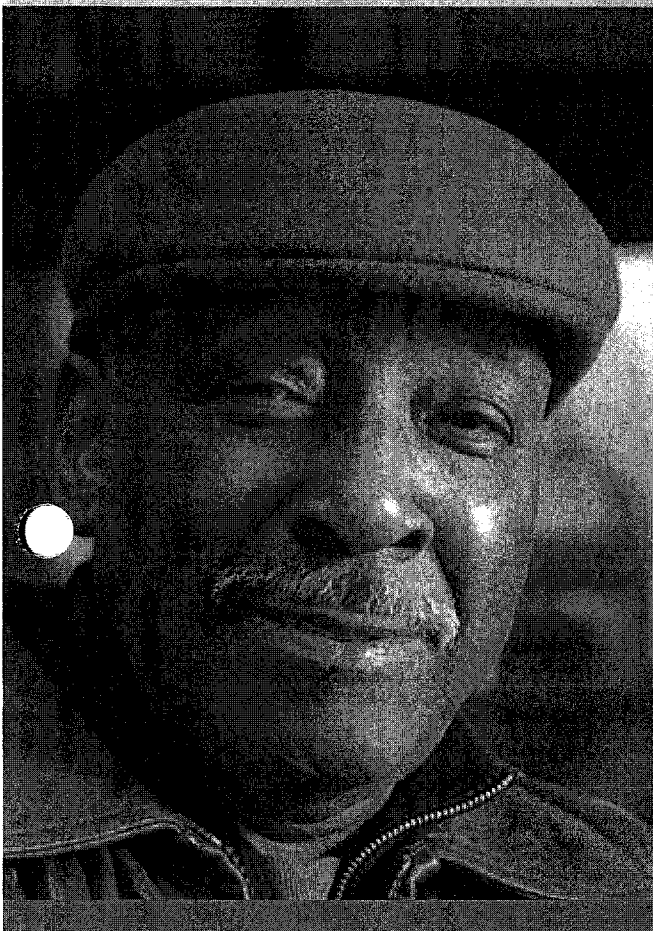
Variables	Public Assistance		Shelter Hardship		Food Hardship		Medical Care Hardship	
	Odds Ratio	p-value	Odds Ratio	p-value	Odds Ratio	p-value	Odds Ratio	p-value
DB pension receipt	0.27	0.000	0.46	0.000	0.51	0.000	0.68	0.003
DC income receipt	0.40	0.000	0.32	0.015	0.36	0.000	0.37	0.000
SS income receipt	0.44	0.000	0.96	0.799	1.00	0.997	1.19	0.252
Current hours worked per week	0.94	0.000	0.99	0.004	0.97	0.000	0.99	0.004
Age	0.97	0.001	0.93	0.000	0.96	0.000	0.94	0.000
Born outside of US	2.04	0.000	0.64	0.034	1.19	0.338	0.89	0.504
8 or fewer years of school completed	5.96	0.000	4.87	0.000	3.60	0.000	3.88	0.000
9-11 years of school	4.56	0.000	3.53	0.000	3.25	0.000	2.91	0.000
High school graduate or GED	2.47	0.000	2.91	0.000	2.12	0.000	2.10	0.000
1-3 years of college	1.90	0.000	3.13	0.000	2.03	0.000	2.41	0.000
Male	0.99	0.903	0.74	0.020	0.80	0.012	0.77	0.020
Widowed	1.46	0.001	1.46	0.009	1.18	0.177	1.42	0.011
Divorced or separated	2.31	0.000	2.19	0.000	2.43	0.000	1.99	0.000
Never married	1.11	0.671	0.99	0.973	0.94	0.820	0.89	0.698
NonHispanic Black	3.07	0.000	3.93	0.000	3.13	0.000	1.44	0.006
Hispanic	2.42	0.000	1.96	0.004	1.99	0.001	0.87	0.527
Other Race	1.92	0.001	1.92	0.010	2.20	0.000	1.17	0.493
Household members	1.56	0.000	1.13	0.012	1.05	0.319	1.17	0.001
Midwest	0.72	0.009	0.75	0.123	0.86	0.323	0.98	0.903
South	0.82	0.077	0.61	0.002	0.73	0.018	1.04	0.773
West	0.78	0.068	0.68	0.063	0.79	0.183	1.09	0.555
Metropolitan area residence	1.06	0.499	0.90	0.244	0.99	0.883	1.07	0.373
Pseudo- R square	0.25		0.14		0.12		0.07	

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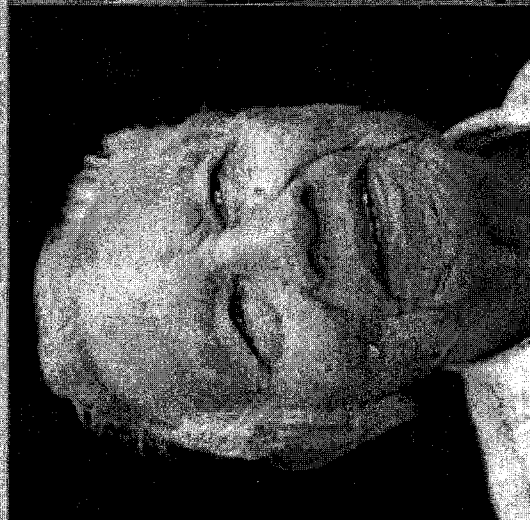
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The Pension Factor

Assessing the Role of Defined Benefit Plans in
Reducing Elder Hardships

by Frank Porell, Ph.D. and Beth Almeida

July 2009

Why We Did This Study

- Examine contribution of defined benefit (DB) pensions to the economic well-being of older Americans
- How much does income from DB pensions protect older Americans from ...
 - Poverty
 - Material hardships
 - Reliance on public assistance



What We Found

- In 2006, income from DB pensions is associated with ...
 - 1.72 million fewer poor households and 2.97 million fewer “near poor” households
 - 560,000 fewer households experiencing a food hardship
 - 380,000 fewer households experiencing a shelter hardship
 - 320,000 fewer households experiencing a healthcare hardship
 - 1.35 million fewer households receiving means-tested public assistance, saving taxpayers \$7.3 billion



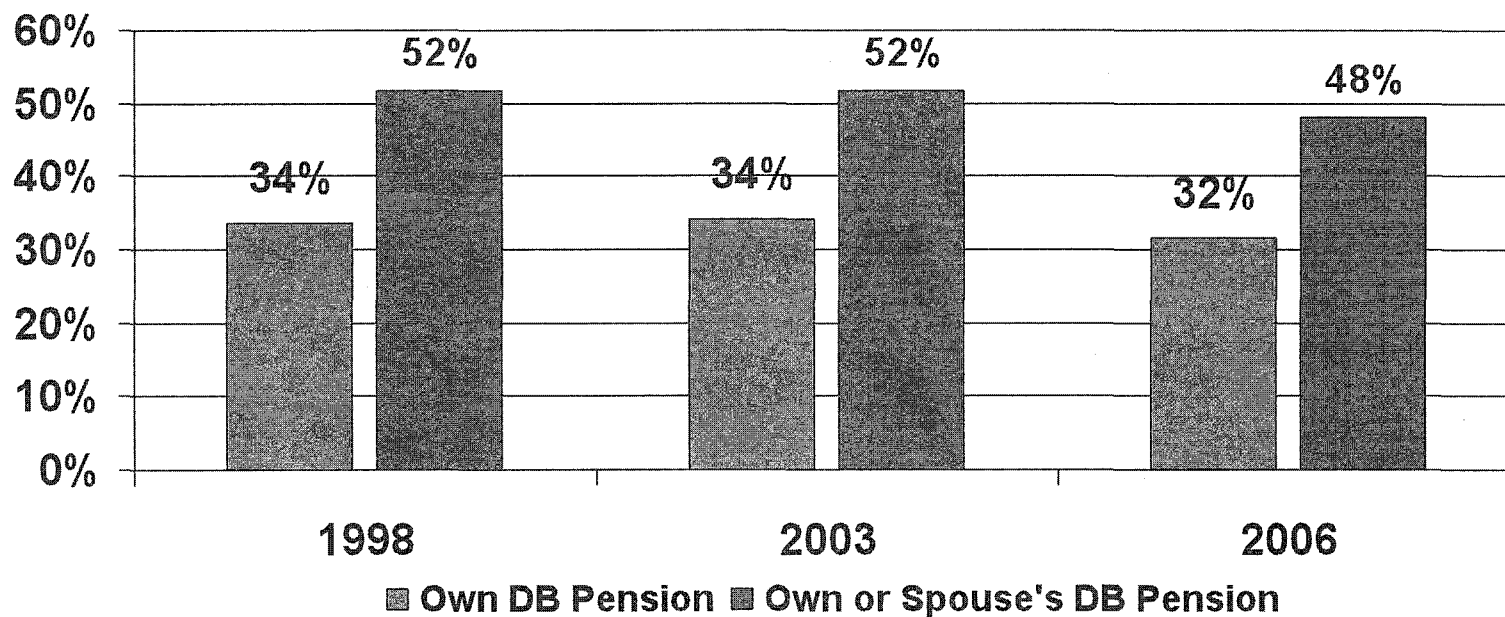
Methodology: What We Did

- Analyzed 2006 data from the U.S. Census Bureau's Survey of Income Program Participation on 10,259 "older households" (head of household was age 60+)
- Descriptive statistics
 - Who has pension income and how much? How has this changed over time?
 - Who experiences poverty, hardships, and public assistance?
- Statistically isolate the effect pensions have on avoiding poverty, hardships, public assistance
- Calculate the effect of pensions in reducing poverty, hardships and public assistance, and associated savings



More Than 23 Million Older Americans Received DB Pension Income in 2006

Percent of Older Americans (60+) with DB Pension Income, 1998, 2003 and 2006



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Source: *The Pension Factor*, Table 1.

DB Pensions Still an Important Source of Income to Middle Class Retirees

DB Pension Income Received by Persons Age 60 or Older (from Own or Spouse's Former Employer)				
	# of Persons (millions)	% of Persons	Mean Pension Amount	Median Pension Amount
All Households	48.6	48.2%	\$18,195	\$12,480
Lowest Quintile	10.9	24.4%	\$4,782	\$3,283
2 nd Quintile	12.7	49.7%	\$9,193	\$7,656
3 rd Quintile	11.2	61.7%	\$17,493	\$15,600
4 th Quintile	8.0	59.1%	\$28,769	\$27,950
Highest Quintile	5.8	47.8%	\$35,335	\$30,574



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Source: *The Pension Factor*, Table 2.

DB Pension Receipt and Income by Gender and Race

DB Pension Income Received by Persons Age 60 or Older (from Own Former Employer Only)				
	# of Persons (millions)	% of Persons	Mean Pension Amount	Median Pension Amount
All Persons	48.6	31.5%	\$15,784	\$11,467
Gender				
Male	21.4	42.0%	\$18,040	\$13,509
Female	27.2	23.3%	\$12,589	\$8,400
Race/ethnicity				
Non-Hispanic White	39.1	32.7%	\$16,136	\$11,730
Non-Hispanic Black	4.2	32.0%	\$13,857	\$9,592
Other Race/Ethnicity	5.3	22.6%	\$14,225	\$10,629



Retirement Security

Source: *The Pension Factor*, Table 2.

Spousal Benefits Shrink the Gender Gap in Pension Receipt and Income

DB Pension Income Received by Persons Age 60 or Older		
	Own Pension Only	Own Pension or Spouse's Pension
% Receiving a Pension		
Female	23.3%	46.9%
Male	<u>42.0%</u>	<u>49.8%</u>
Gender Gap	-23.3%	- 2.9%
Median Amount of Pension		
Female	\$8,400	\$11,664
Male	<u>\$13,509</u>	<u>\$14,364</u>
Gender Gap	-\$5,109	-\$2,700



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Source: *The Pension Factor*, Table 2.

Households with Pension Income Less Likely to be Poor, “Near Poor”

% of Older Households with Incomes Exceeding Poverty Thresholds				
	# of Households (millions)	% of Households Classified as...		
		Poor*	Near Poor**	Not Poor
All Households	31.6	9.0%	25.5%	65.5%
Households with DB Pension Income	15.0	2.4%	16.2%	81.5%
Households with No DB Pension Income	16.6	15.1%	33.9%	51.0%

*“Poor” is defined as income at or below the federal poverty line

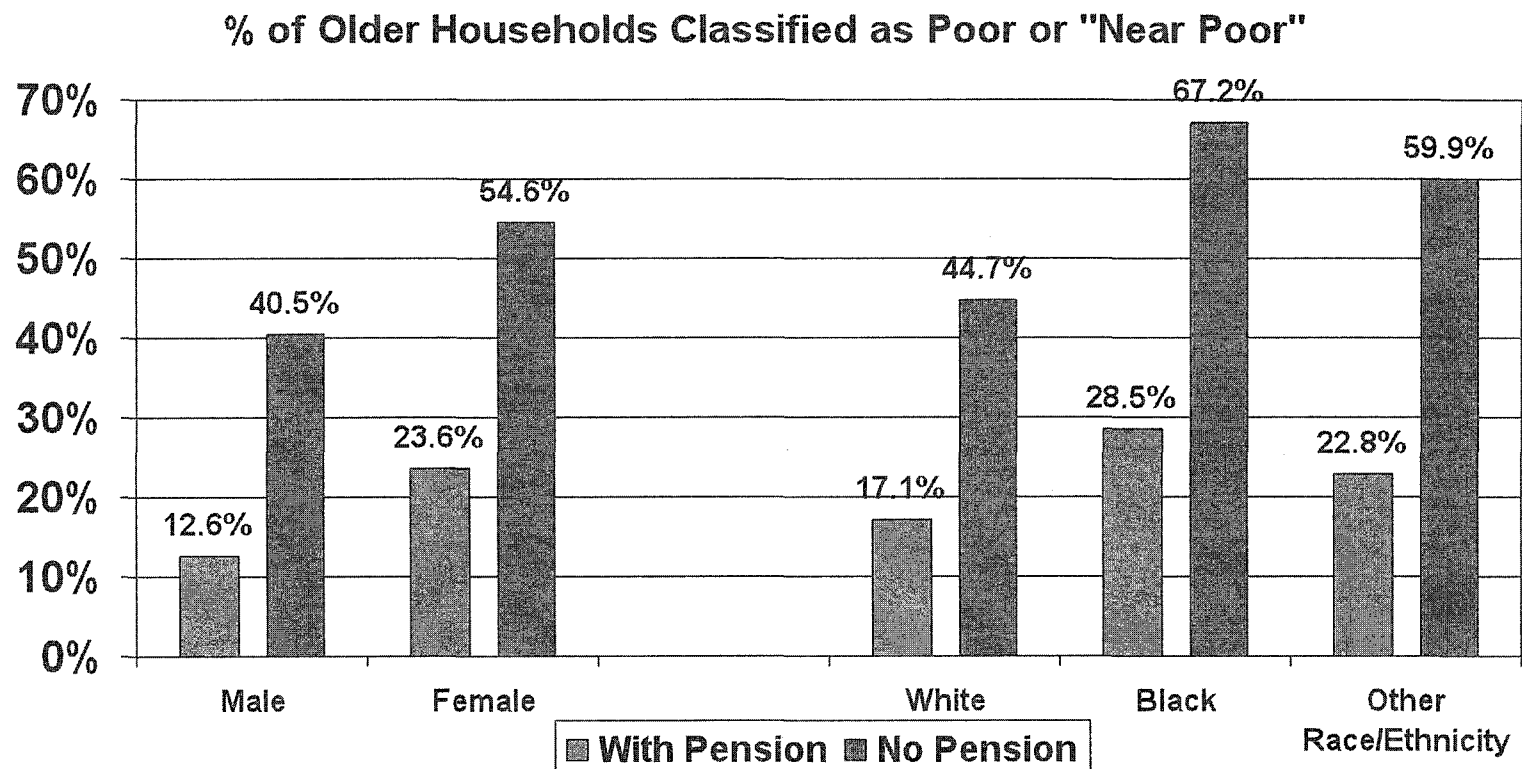
**“Near poor” is defined as 2x the federal poverty line



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Source: *The Pension Factor*, Table 4.

Gender and Race Gaps in Poverty Shrink Among Those with Pensions



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Source: *The Pension Factor*, Table 4.

Households with Pension Income Less Likely to Report Hardships

% of Older Households Reporting Hardships				
	# of Households (millions)	Food Insecurity Hardship*	One or More Shelter Hardships**	One or More Healthcare Hardships***
All Households	31.6	4.7%	4.6%	6.0%
Households with DB Pension Income	15.0	2.6%	2.4%	4.2%
Households with No DB Pension Income	16.6	6.7%	6.6%	7.8%

*These include running out of food, skipping meals, eating less than needed, etc.

**Unable to pay full amount of rent, mortgage or utilities

***In past year, did not see a doctor/dentist when there was a need to see one.

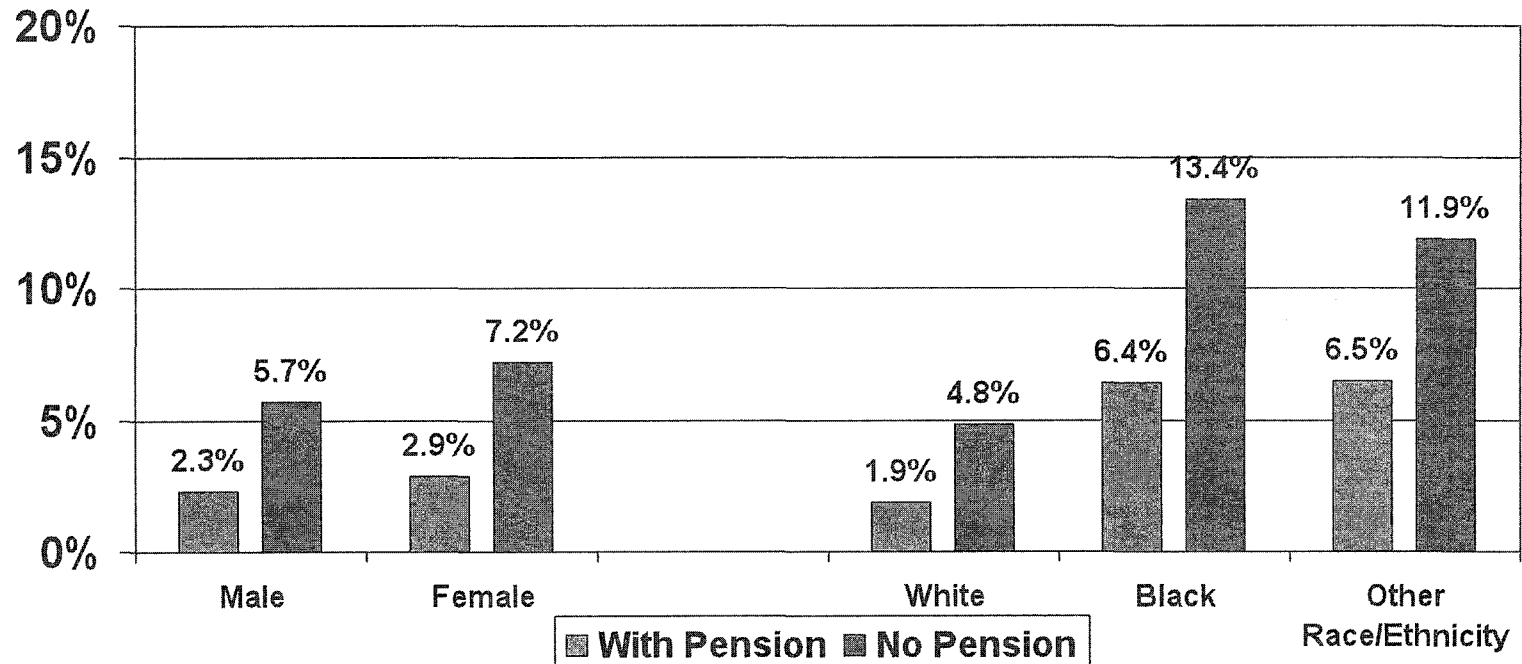


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Source: *The Pension Factor*, Table 5.

Gender and Race Gaps in Hardships Shrink Among Those with Pensions

% Of Older Households Reporting Food Insecurity Hardship



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Source: *The Pension Factor*, Table 5.

Households with Pension Income Less Likely to Receive Assistance

% of Older Households Receiving Public Assistance				
	# of Households (millions)	% with Public Assistance*	Mean Amount Received	Median Amount Received
All Households	31.6	10.9%	\$5,373	\$3,779
Households with DB Pension Income	15.0	4.6%	\$4,558	\$2,976
Households with No DB Pension Income	16.6	16.6%	\$5,578	\$3,890

*Includes means-tested cash transfers (e.g. SSI, general assistance) and/or noncash assistance (e.g. food stamps, rent subsidies, energy assistance)

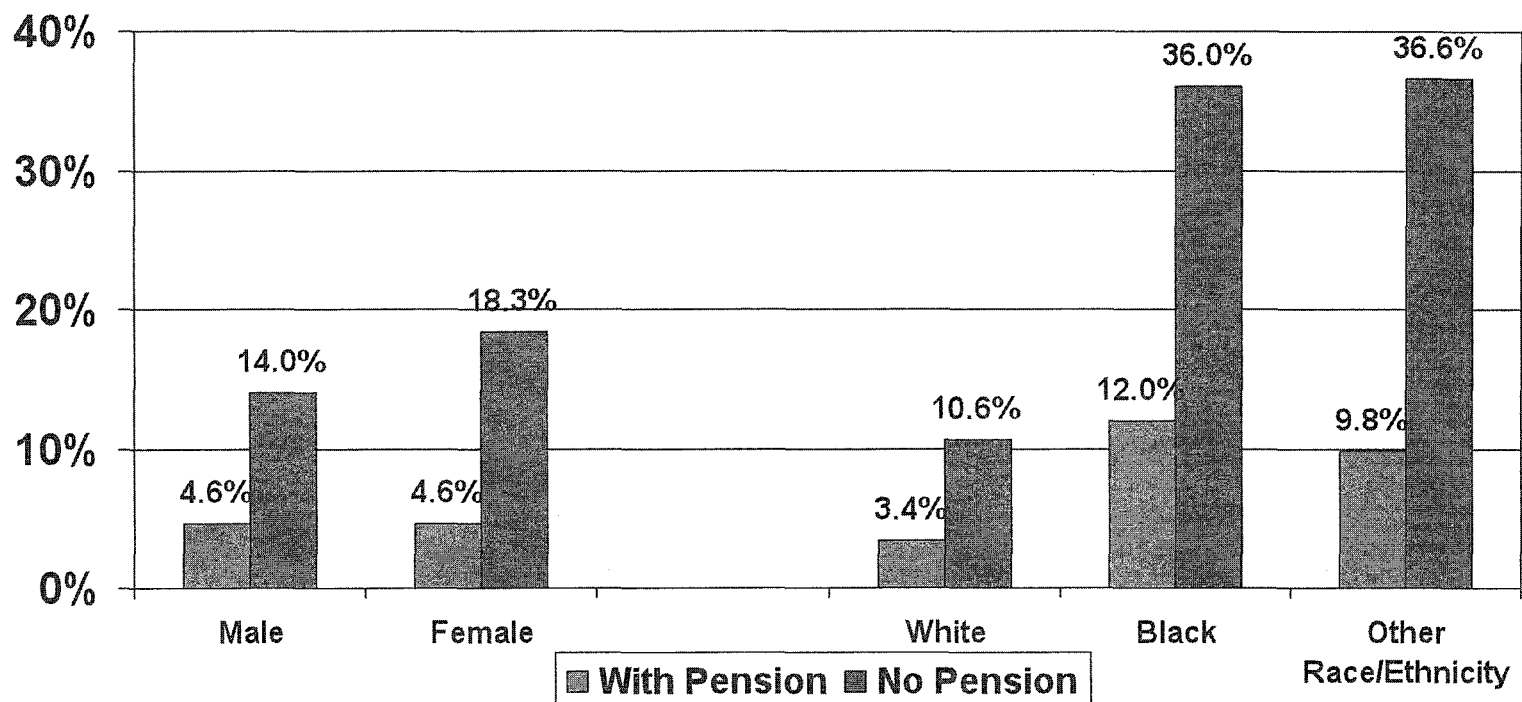


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Source: *The Pension Factor*, Table 6.

Gender and Race Gaps in Assistance Shrink Among Those with Pensions

% of Older Households Receiving Public Assistance



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Source: *The Pension Factor*, Table 6.

Isolating “The Pension Factor”

- How do we know that it is DB income (and not some other factor) that is enabling older households to avoid poverty, hardships, public assistance?
- Other factors like education, work history, pre-retirement income, age, gender, race, marital status, etc. could all play a role in whether an older household experiences poverty or hardship
- Solution: statistical model that controls for these socio-demographic characteristics

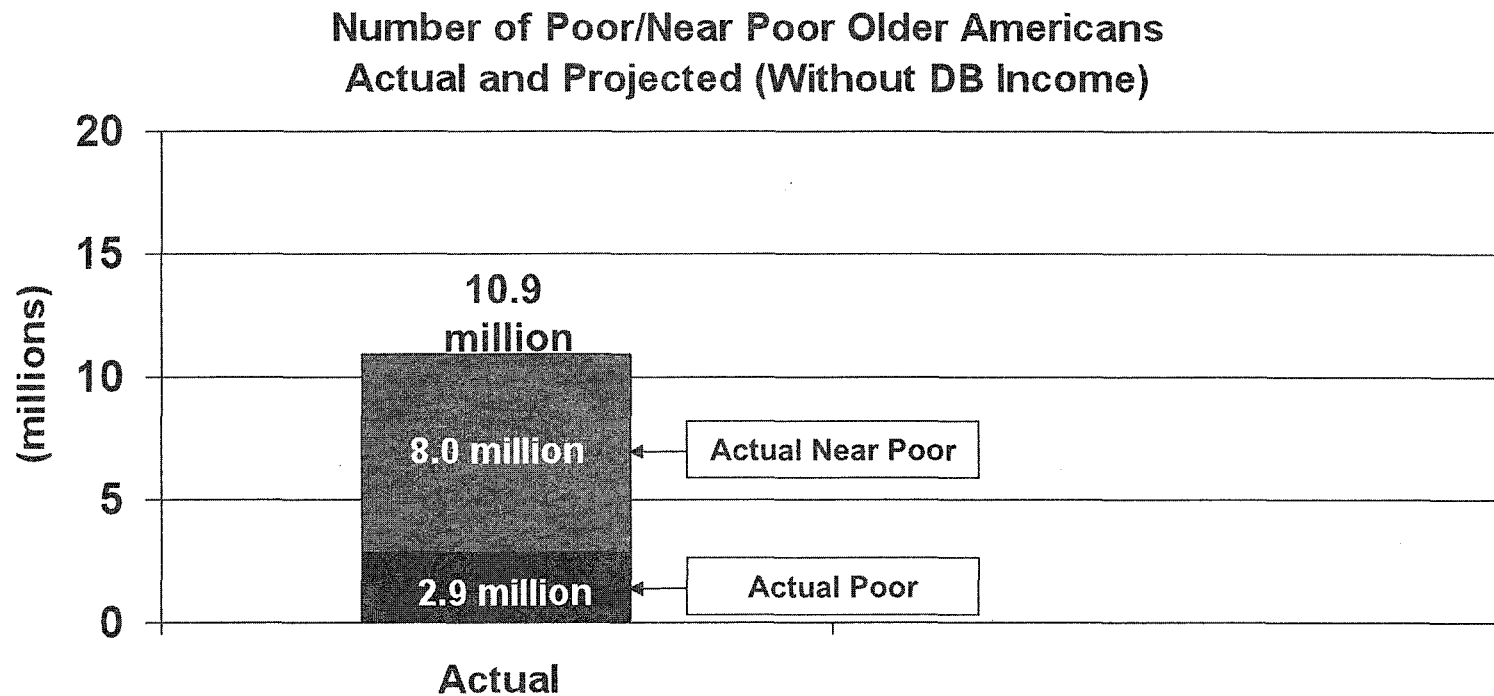


Statistical Approach

- Estimate models to derive predicted probabilities of whether a household experiences poverty, hardship, public assistance based on a range of socio-demographic factors, including whether household has DB pension, DC, and Social Security income.
- For each household with pension income, replaced its predicted probabilities with those of a household with the **same** socio-demographic factors but **no** DB pension income.
- Project how much poverty, hardships, public assistance increases as a result.



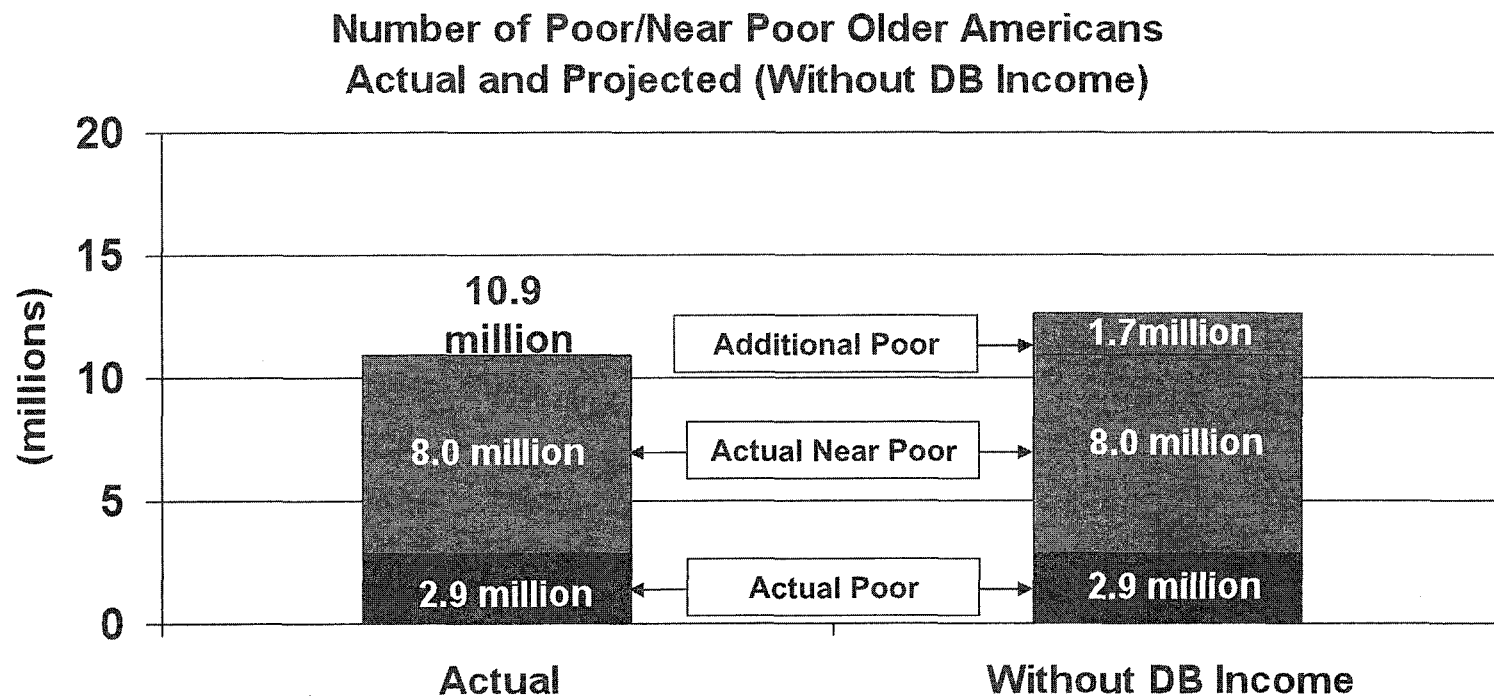
DB Income Helps Large Numbers Avoid Being Poor, Near Poor



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Source: *The Pension Factor*, Table 7.

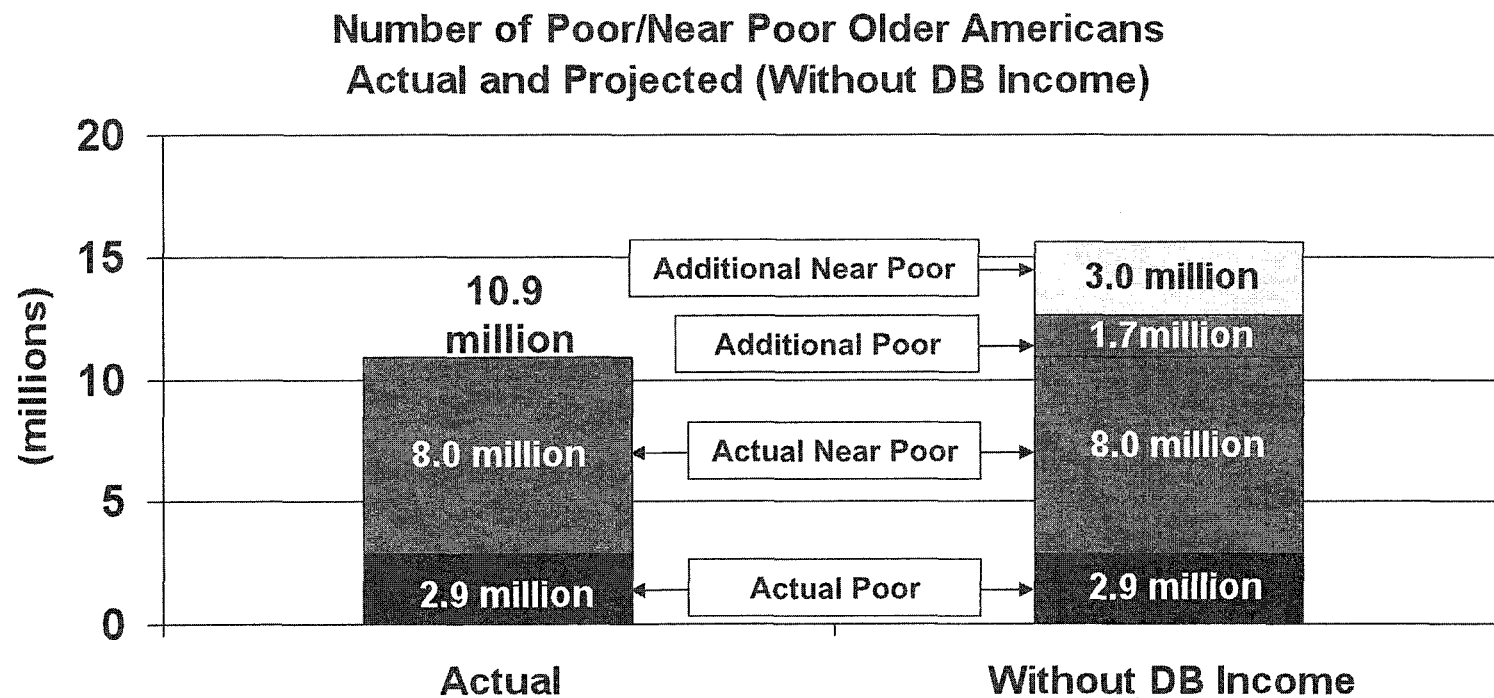
DB Income Helps Large Numbers Avoid Being Poor, Near Poor



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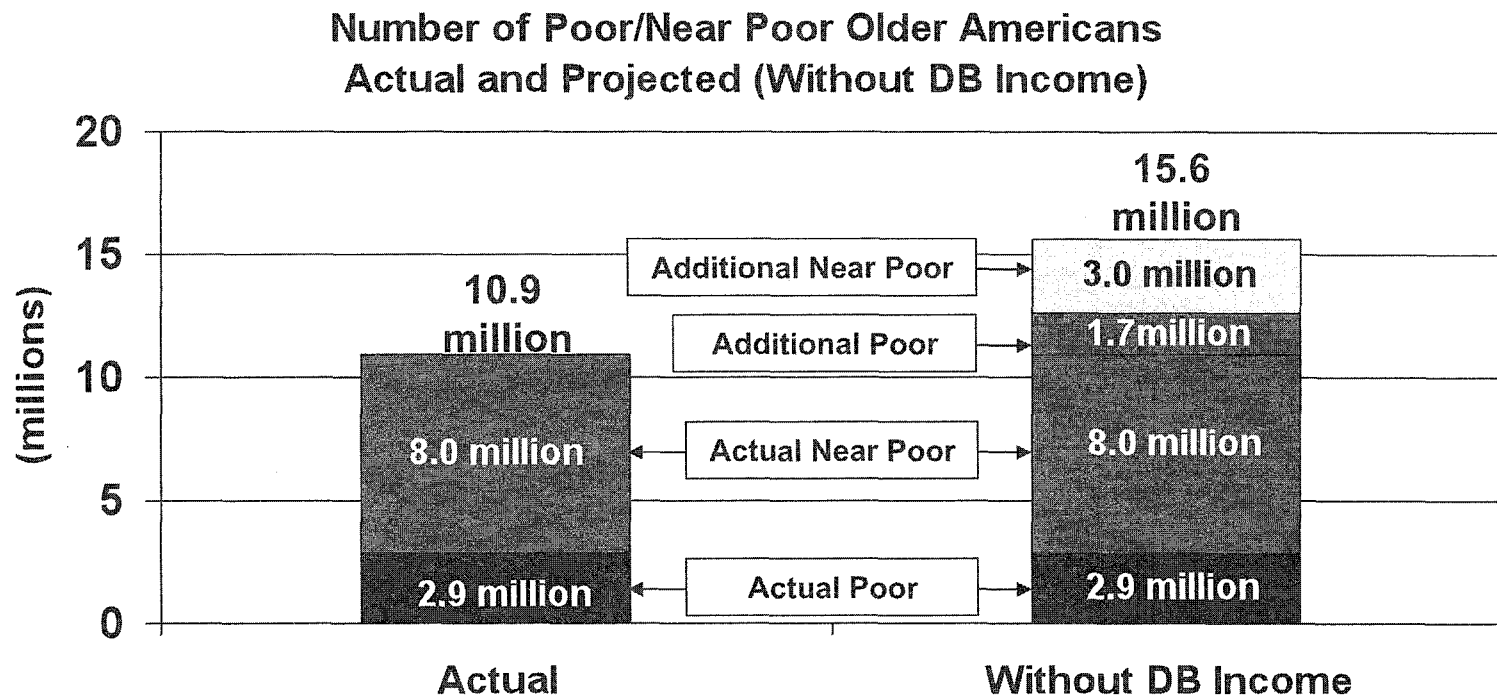
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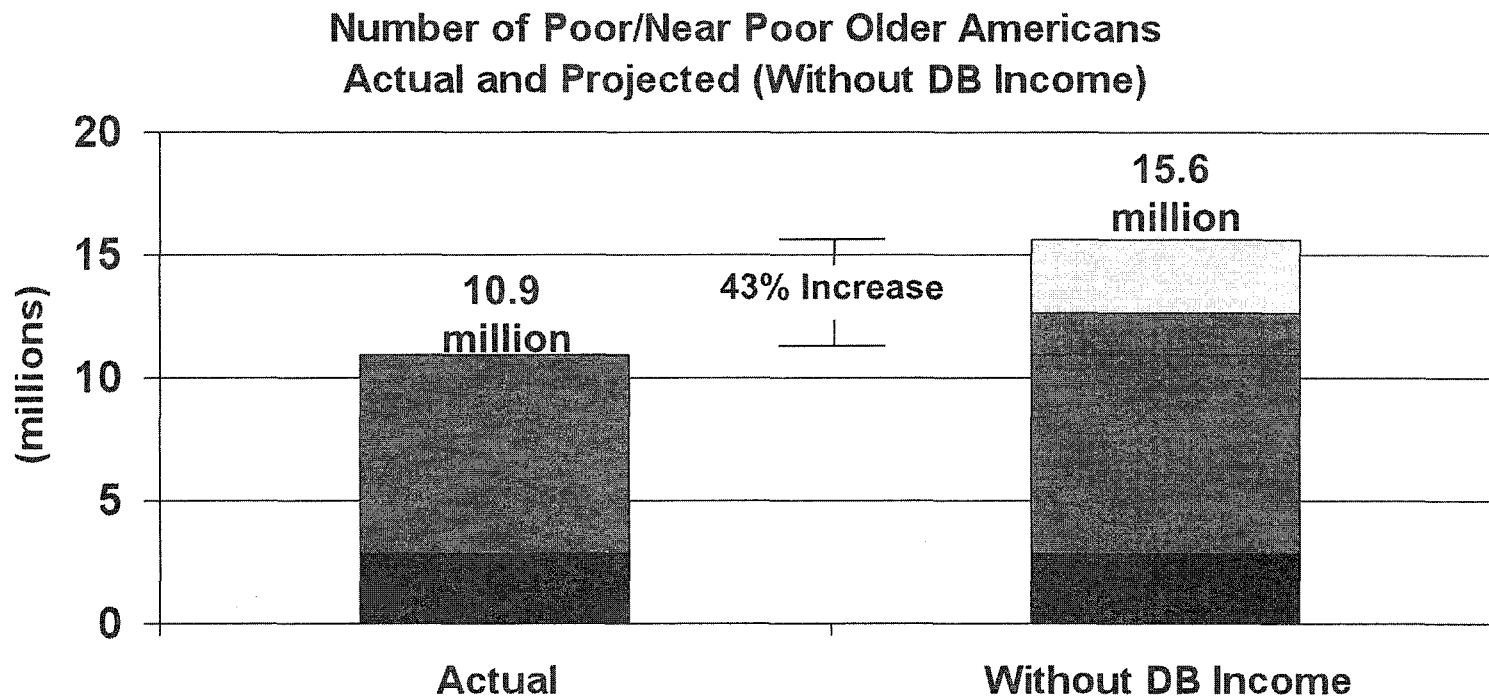


Source: *The Pension Factor*, Table 7.

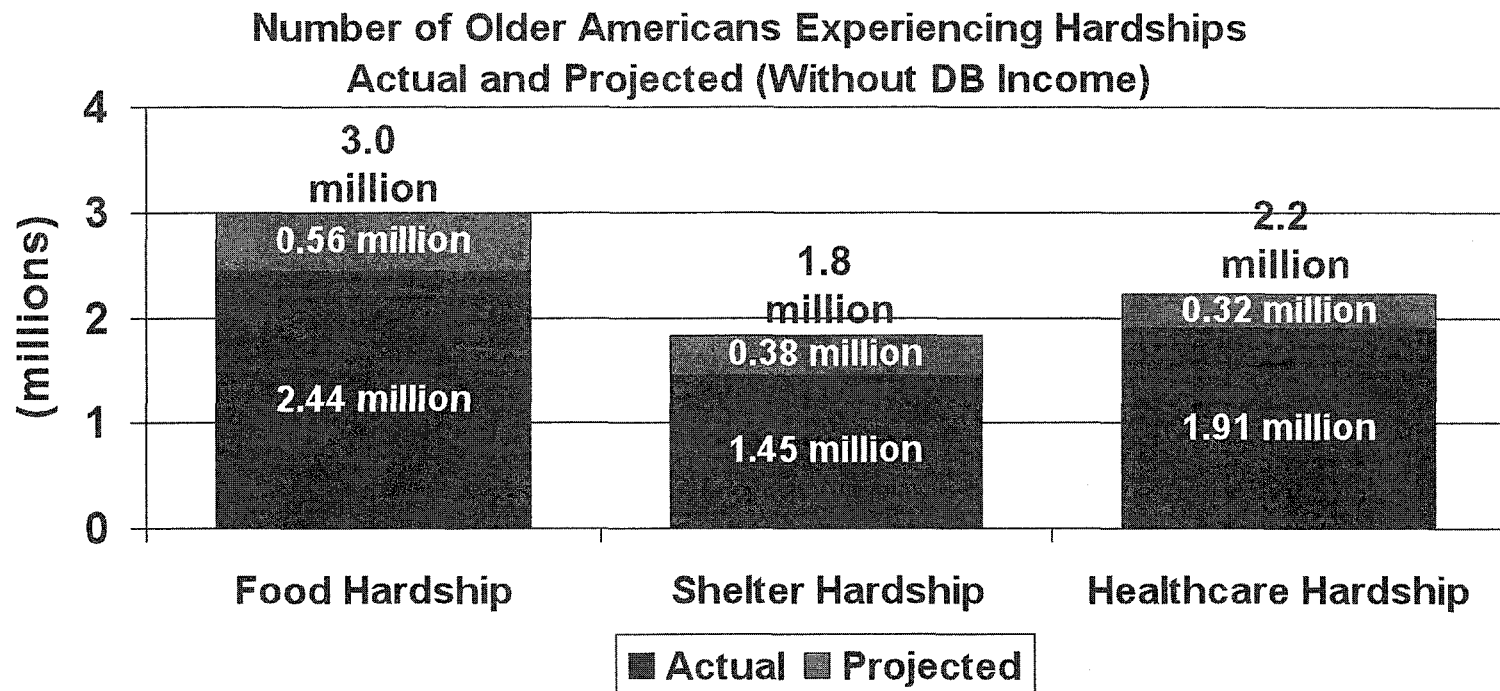
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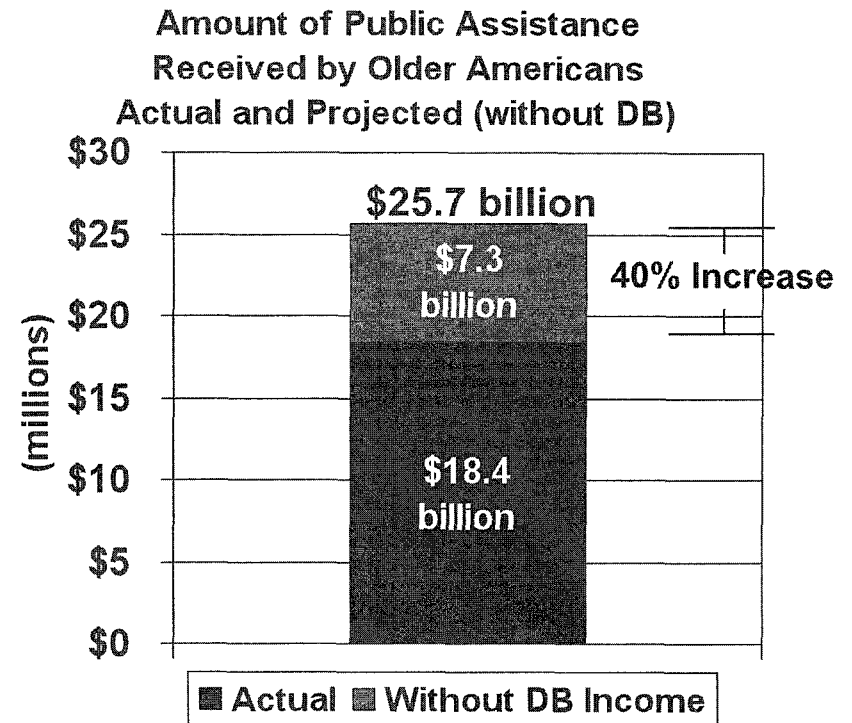
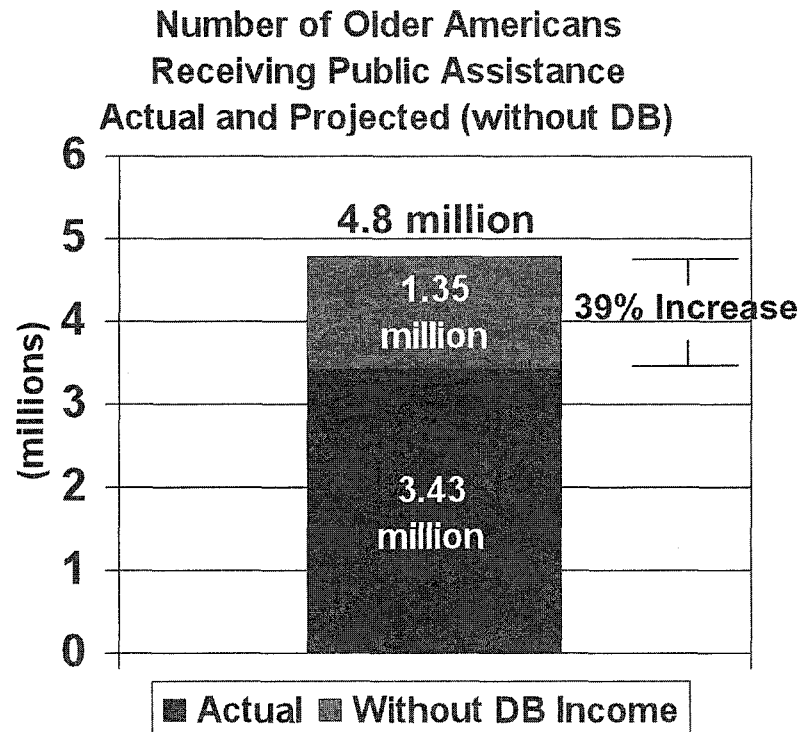
DB Income Helps Large Numbers Avoid Hardships



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Source: *The Pension Factor*, Table 8.

DB Income Helps Large Numbers Avoid Public Assistance



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Source: *The Pension Factor*, Table 8.

Conclusions

- In 2006, income from DB pensions is associated with ...
 - 1.72 million fewer poor households and 2.97 million fewer “near poor” households
 - 560,000 fewer households experiencing a food hardship
 - 380,000 fewer households experiencing a shelter hardship
 - 320,000 fewer households experiencing a healthcare hardship
 - 1.35 million fewer households receiving means-tested public assistance, saving taxpayers \$7.3 billion



Conclusions

- Income from DB pensions significantly contributes to the well-being of older Americans
- DB plans seem to especially reduce risks for vulnerable populations – women and minorities
- Elder poverty, material hardships and reliance on public assistance would be much greater in the absence of DB pension income



I Point
Referred Senator
ELTON & I
Have ~~not~~ ^{been}
Talked
I listened to Senator ELTON

SPENT a lot of
Time RESEARCHING
& REFLECTING on these issues

Who I am. 20 years CFO, extensive time on PERS/TRS issue.

Though my prior PERS/TRS work was Driven By Position ASCFO,
Not speaking for the FNSB, Mayor & Assy not taken a position.

Given the time I've spent PERS/TRS through the years,
I ~~also~~ fully acknowledge, and am quite respectful that there are differing and valid views to the question at hand.

Think you FOR THIS OPPORTUNITY TO share some of my THOUGHTS ~~DATE~~ ^{AS A LIT CEO}
I will try and stay focused on only those few points that I think are the most relevant to the issue of restoring a DB plan.

First, I concur with several points in the Sponsors Statement, specifically: 1) recruitment and retaining employees is an issue, has been an issue, and will become a bigger issue as boomer demographic changes occur, 2) most public employees are put into greater risk, as relates to retirement capabilities, using individual savings plans because as the Sponsor states these accounts earn much less than professionally managed pension funds. 3) oversight has been beefed up with two actuaries, and the other improvements made. ^{TO THE STATEMENTS}
_{have been}

Specifically, let me say that I believe the following to be true:

1) **My first choice would be the continuation of both plans**, the development of both have been paid for. ^{there are both being maintained} In most instances the DB plan I believe should be used, but there are occasions wherein it is beneficial to both the employee and the employer for that employee to enter in to a DC plan. For example, many short-term intended employees are better off in a DC plan. Employees that actually retire from the DB plan ~~that~~ ^{but} may on a short-term ^{basis} serve the needs of an employer is also the perfect example of where a DC plan makes sense. I believe once an employee retires from the DB plan, they shouldn't go back into a DB plan and should use a DC plan. _{we in fact are extremely fortunate to have retired staff come back in the summer as audit temps}

melanie
milkers
&
charlene
morrison
analysis

2) The **cost to the employer of a DB and a DC plan are about the same**, and depending on what year you are talking about, the DB plan might be cheaper. The FY '10 normal cost rate is 9.46%, as compared to a DC rate of slightly over 10%, depending on the health reimbursement arrangement. Further, in the DB plan if an employee leaves before they are vested, the employers contribution into the Plan on behalf of that employee, over their employment period, remains in the plan.

3) **PERS created, from my view of the world, a short-term, a mid-term, and a long-term issue**. The **short-term** issue (which we are still dealing with) really was the impact to all of our budgets across the state because of the increased cost resulting from the very large change in the past service cost component of the rate. The **mid-term** issue is focused around our ability as entities to actually be competitive in the market place and hire and retain employees to provide the programs and services we are charged with delivering. I believe we have begun to feel the effects of this hiring and retainage issue, without reinstating a DB option I am quite fearful that our abilities to hire and retain will only get progressively worse. In the **long-term** I really fear that not going back to a DB plan will surely create a situation where another huge component of our population will not be prepared for retirement, and will in the end, cost government more money to provide assistance to them than if the government had managed a DB plan on their behalf. ^{in the long term} This whole issue is analogous to the discussions that occurred several years ago when some wanted a portion of employees pay to not go into the SS system, ^{ADP PLAN} but to be individually managed. What recent times should've made abundantly clear is that there are very few individuals that are knowledgeable enough, informed enough, disciplined enough, long-term horized enough to set up and manage a multi-decade retirement plan with proper allocation of their assets, should they have been disciplined enough to set aside a proper

amount on a continuous basis throughout their lifetime. I'm fearful that even with a well set up DC plan, most individuals are in-fact emotional investors, the result being that they'll be ill prepared financially for retirement. A DB plan is a great equalizer for hard working persons who don't have the time, knowledge, or inclination to diligently manage their retirement funds.

Sunk costs

4) **The existing unfunded liability issue, really, is not relevant in this decision.** For this position and statement to not be true, one would have to be willing to argue that future normal cost rates are going to be set lower than they should be by the actuary. The "rate" an individual employer pays is comprised of two rate components, the normal cost rate and the past service cost rate. When the normal cost rate is set properly, there is no need for a supplemental past service cost rate. If normal cost rates had been set properly in prior years, there would be no past service cost component, or, it would be an immaterial amount and there would be no need to discuss PERS and/or TRS under-funding.

If we all closed our doors, the unfunded stuffs the same

ie no unfunded obligation gets created

The unfunded liability was not driven by investment problems, as many believed. As Callan and Associates conveyed on 10/12/06 to the ARMB, PERS & TRS have achieved annualized total returns of 8.89% and 8.96%, respectively. The expected rate of return is 8.25%.

concern w/sonston ELTO's comments on TIER I HAVING BEEN THE MAJOR CONTRIBUTOR

There is substantial testimony and documentation to the legislature that the main causes of the underfunding was actuary errors.

Testimony..

In short, let me restate, that unless you believe that future normal cost rates are going to be set as irresponsibly as those brought forth by Mercer in the later 90's, the existing unfunded liability is not relevant to DB vs DC discussion.