

ALASKA LEGISLATURE

HOUSE and SENATE FINANCE COMMITTEE FILES, 2005-2006 3012

Replaces # 2
FISCAL NOTE

STATE OF ALASKA
2005 LEGISLATIVE SESSION

Fiscal Note Number: _____
Bill Version: HCS CSSB141 (STA)
() Publish Date: _____

Revision Date/Time (Note if correction): _____ Dept. Affected: Administration
Title: An Act relation to TRS and PERS creating a RDU: Centralized Administrative Services
defined contribution and health reimbursement plans..... Component: Retirement and Benefits
Sponsor: Senate Finance Committee
Requester: Senate Finance Committee Component No.: 64

Expenditures/Revenues (Thousands of Dollars)

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

OPERATING EXPENDITURES	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
Personal Services	276.5	227.5	163.1	163.1	163.1	163.1
Travel	37.5	17.5	3.5	5.0	5.0	5.0
Contractual	667.0	327.0	352.0	397.0	397.0	397.0
Supplies	18.0	5.0	5.0	5.0	5.0	5.0
Equipment	30.0					
Land & Structures						
Grants & Claims						
Miscellaneous (Board Restructure)	(12.5)	(41.5)	(41.5)	(41.5)	(41.5)	(41.5)
TOTAL OPERATING	1,016.5	535.5	482.1	528.6	528.6	528.6

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

1002 Federal Receipts						
1003 GF Match						
1004 GF	1,029.0	577.0	392.7	285.1	142.5	0.0
1005 GF/Program Receipts						
1037 GF/Mental Health						
1029 PERS	(2.0)	(4.1)	(4.1)	(4.1)	(4.1)	(4.1)
1034 TRS	(10.5)	(37.4)	(37.4)	(37.4)	(37.4)	(37.4)
Other (Specify Type--Do not abbreviate)			130.9	285.0	427.6	570.1
TOTAL	1,016.5	535.5	482.1	528.6	528.6	528.6

Estimate of any current year (FY2005) cost: 0.0

Check this box (X) if funding for this bill is included in the Governor's FY 2006 budget proposal:

POSITIONS

Full-time	2	2	2	2	2	2
Part-time	0	0	0	0	0	0
Temporary	3	2	1	1	1	1

ANALYSIS: (Attach a separate page if necessary)

This bill will create a new defined contribution retirement plan and a health reimbursement arrangement for new employees of the PERS and TRS hired after the effective date of July 1, 2005. As the new plan significantly differs from the current defined benefit plans, the division will be required to reprogram its computer systems, set up and account for two new plans, create new plan publications and forms, train staff, employer contacts and new members, create new employee benefit education methods on the web, benefit seminars and one on one appointments, and to contract for financial planning services for members of the new plan. The fiscal note assumes fund manager fees, custody, and record keeper's individual account fees are separate. It further assumes that cost reductions for the PERS and TRS Boards will be partially offset by payments to the Office of Administrative Hearings to conduct disability hearings, previously conducted by the boards.

Prepared by: Melanie Millhorn, Director Phone: 465-4408
Division: Retirement and Benefits Date/Time: 4/22/05 3:29 PM
Approved by: Mike Tibbles, Deputy Commissioner Date: 4/22/2005
Agency: Department of Administration

FISCAL NOTE

STATE OF ALASKA
2005 LEGISLATIVE SESSION

BILL NO. HCS CSSB141 (STA)

ANALYSIS CONTINUATION

The estimated administrative costs to the division by fiscal year are as follows:

	FY 2006	FY 2007	FY 2008	FY 09-11
PERSONAL SERVICES:				
1 - Non Perm Analyst-Pgmr III - DC-Benefits Sys - R 16	64.4	64.4	64.4	64.4
1 - Accountant II - Range 16	52.0	52.0	52.0	52.0
1 - R&B Tech I/II - ER Rpting / Contrib. Recon. - Range 12	46.7	46.7	46.7	46.7
1-Non Permanent Publications Tech II or Spec I - Range 13	49.0	0.0	0.0	0.0
1-Non Permanent Retirement Counselor - Range 18	64.4	64.4	0.0	0.0
	<u>276.5</u>	<u>227.5</u>	<u>163.1</u>	<u>163.1</u>
TRAVEL:				
Employer Reporting Software Upgrade Install & Help	30.0	15.0	0.0	0.0
Employer Plan Education	7.5	0.0	0.0	0.0
Regional Counselor travel	0.0	2.5	3.5	5.0
	<u>37.5</u>	<u>17.5</u>	<u>3.5</u>	<u>5.0</u>
CONTRACTUAL:				
Communications & Postage	82.0	17.0	17.0	17.0
Computer System Redesign (Est. 2,500 hours in FY06)	320.0	30.0	30.0	30.0
Audit, Accting, Tax, Benefits Consulting, Legal	100.0	75.0	50.0	50.0
Training \ Risk Management	15.0	5.0	5.0	0.0
Employee financial planning services	150.0	200.0	250.0	300.0
	<u>667.0</u>	<u>327.0</u>	<u>352.0</u>	<u>397.0</u>
SUPPLIES: Office supplies, calculators, desk-top software	18.0	5.0	5.0	5.0
EQUIPMENT: Workstation & cubicle, chairs, file cabinets, computers, telephone, set-up costs	30.0	0.0	0.0	0.0
MISCELLANEOUS (BOARD RECONFIGURATION, HEARINGS)				
Board Member Election 2006/2008	0.0	0.0	0.0	0.0
Board Training	-15.0	-15.0	-15.0	-15.0
Board Attorney	-40.5	-40.5	-40.5	-40.5
Travel Members/Staff	-24.0	-24.0	-24.0	-24.0
Honorarium/Board Members	-29.0	-29.0	-29.0	-29.0
National Seminars (NASRA - NCTR)	-20.0	-20.0	-20.0	-20.0
Disability Hearings--Office of Administrative Hearings	116.0	87.0	87.0	87.0
	<u>-12.5</u>	<u>-41.5</u>	<u>-41.5</u>	<u>-41.5</u>
TOTAL	1,016.5	535.5	482.1	528.6

The above funding source is initially listed as General Fund because the existing tiers of PERS / TRS are Defined Benefit plans, and the present DC plans, SBS and DCP are legally separate from the intended plan. It is assumed that by FY2008, as more employees are hired into the new tiers, that program costs will be funded through an assessment on DC accounts, similar to the SBS program currently in place. General funds will be reduced 25% per year from FY2008-2011.

The new plan effective date is July 1, 2005. Therefore, startup costs will start in FY 05. The startup costs are not costs of the PERS and TRS Defined Benefit plans. Tiers 1, 2, and 3 are logically related; however, tier 4 PERS and Tier 3 TRS would not be. The purpose of the bill is to separate the DB and DC side. A legal opinion was sought to determine how the funding and accounting needs to occur for the new DC plan.

Alaska Retirement System Boards

Board	Alaska State Pension Investment Board (ASPIB)	Alaska Teachers' Retirement Board	Public Employees' Retirement Board	ASRB 141 (FIN)
Mission	Provide prudent and productive management and investment of state pension funds	Prescribe policies and regulations necessary to administer the TRS system	Prescribe policies and regulations necessary to administer the PERS system	Trustee of retirement system assets; manage and invest these assets in a manner that is sufficient to meet the liabilities and obligations of the system
Statutory Authority	AS 37.10.210	AS 14.25.035	AS 39.35.030	SB 141 (37.10.210)
State Department	Revenue	Administration	Administration	Revenue
Board Members	8 Trustees	5	5	9 Trustees
Composition	<ul style="list-style-type: none"> Commissioner of Revenue 3 – Appointed by Governor from public at large 2 – Elected from PERS members 2 – Elected from TRS members 	<ul style="list-style-type: none"> 5 – Governor appointed from public at large 	<ul style="list-style-type: none"> 3 – Appointed by Governor from public at large 2 – Elected from PERS membership 	<p><u>All Appointed by the Governor</u></p> <ul style="list-style-type: none"> Commissioner of Revenue Commissioner of Administration 3 Alaska residents who do not participate in the retirement systems 1 finance officer of a political subdivision 1 finance officer of a school district 1 PERS member (active or retired) 1 TRS member (active or retired)
Special Requirements	<ul style="list-style-type: none"> One appointee must represent a system employer other than the State of Alaska Appointees must have business and investment experience 	<ul style="list-style-type: none"> One appointee must be a resident receiving benefits from the system 	<ul style="list-style-type: none"> One appointee must have been employed by other than the State of Alaska at some time 	<ul style="list-style-type: none"> All trustees must have recognized competence in one or more fields of investment management, finance, banking, economics, accounting, pension administration, or actuarial analysis
Terms	<ul style="list-style-type: none"> 4 yr staggered terms No term limits 	<ul style="list-style-type: none"> Appointed – 3 yr overlapping No term limits 	<ul style="list-style-type: none"> Appointed members – 6 yr scattered Elected members – 6 yr No term limits 	<ul style="list-style-type: none"> Staggered three years Limited to three consecutive terms A year break before serving again
Special Members	3 to 5 member Investment Advisory Council	4	4	Optional Investment Advisory Council
Composition	<ul style="list-style-type: none"> Appointed by ASPIB for 3 yr staggered terms Dr. William Jennings (6/30/05) Dr. Jerrold Mitchell (6/30/07) Tim O'Brien (6/30/06) 	<ul style="list-style-type: none"> 2 – Physicians 2 – Physician alternates All appointed by the Governor PERS & TRS Boards may make recommendations to the Governor 	<ul style="list-style-type: none"> 2 – Physicians 2 – Physician alternates All appointed by the Governor PERS & TRS Boards may make recommendations to the Governor 	3 to 5 member Investment Advisory Council
Special Requirements	<ul style="list-style-type: none"> Shall possess experience & expertise in financial investments, portfolio management, etc 	<ul style="list-style-type: none"> Licensed in Alaska Hear medical disability eligibility appeals only 	<ul style="list-style-type: none"> Licensed in Alaska Hear medical disability eligibility appeals only 	<ul style="list-style-type: none"> Shall possess experience & expertise in financial investments, portfolio management, etc.
Terms	Pleasure of ASPIB	Pleasure of the Governor	Pleasure of the Governor	Pleasure of the ARMB

Board	Alaska State Pension Investment Board (ASPIB)	Alaska Teachers' Retirement Board	Public Employees' Retirement Board	CS SB 141 (FIN)
Powers/Duties	AS 37.10.220 <ul style="list-style-type: none"> • Hold regular meetings • Establish investment policies • Submit quarterly & long-range investment reports to LB&A • Select and retain external investment managers and custodians • Develop annual operating budget and present to OMB • May assume fiduciary and management responsibilities for other state funds 	<ul style="list-style-type: none"> • Hold public hearings • Adopt system policies and regulations • Set regulations and procedures for conduct of the Board • Act as an appeals board • Acquire biennial actuarial valuation • Set employer contribution rate • Determine employee's past service liquidation amounts • Waive benefit adjustment requirements when appropriate • Adopt regulations for the election and removal of ASPIB trustees 	AS 39.30.155 <ul style="list-style-type: none"> • Hold public hearings • Hold board elections • Adopt system policies and regulations • Set regulations and procedures for conduct of the Board • Act as an appeals board • Acquire biennial actuarial valuation • Set employer contribution rate • Determine employee's past service liquidation amounts • Prescribe interest rates • Prescribe policies for the supplemental employee benefit program • Waive benefit adjustment requirements when appropriate • Adopt regulations for the election and removal of ASPIB trustees • Adopt a contribution surcharge (AS 39.35.160) 	SB 141 (AS 37.10.220) <ul style="list-style-type: none"> • Manage the assets of the defined benefits trust fund to meet pension liabilities. • Adopt investment policies for each of the funds entrusted to the board • Annual actuarial valuation of system plans • Analysis of actuarial assumptions experience: <ul style="list-style-type: none"> ○ Health costs assumptions annually. ○ All other assumptions not less than every four years. • Audit of actuary not less than every four years. • Rate setting: <ul style="list-style-type: none"> ○ Employer contribution rates, including "normal cost" and "past service cost". ○ Employee contribution rates to the extent that the normal cost rate increases so that 50 percent would be higher than the current rates set in statute. ○ Interest rates credited to individual employee accounts. ○ Interest rates credited to employee HRA account records. • Provide a range of investment options for all employee-directed accounts. • Select and retain investment managers and custodians for the funds • Obtain an external performance review to evaluate the investment policies and performance of each fund • Submit regular reports on the financial condition of the systems

PERS Tier I 1/1/61 - 6/30/86	PERS Tier II Entered on or after 7/1/86	PERS Tier III Entered on or after 7/1/96	SB 141 Proposed DC Plan Entered on or after 7/1/2006
Employee Pre-tax 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	Employee Pre-tax 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	Employee Pre-tax 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	Employee Pre-tax Contribution: 8.0% beginning 7/1/2005
Members vest with 5 years of service.	Members vest with 5 years of service.	Members vest with 5 years of service.	<ul style="list-style-type: none"> Employee is immediately vested in their own contributions Employee's gradually vest in employer contributions <ul style="list-style-type: none"> 25% after two years 50% after three years 75% after four years 100% after five years
<ul style="list-style-type: none"> Normal retirement age is 55 Early retirement age is 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. 	<ul style="list-style-type: none"> Normal retirement age is 60 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 	<ul style="list-style-type: none"> Normal retirement age is 60 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 	<ul style="list-style-type: none"> Retirement Savings: Employee can terminate at any age and take vested account balance with them, leave it in the plan or rollover to another qualified plan. Medical Benefits: Member is eligible for benefits if: <ul style="list-style-type: none"> 65 years of age and at least 10 years of service; or 25 years of service police/firefighters 30 years of service all others
<ul style="list-style-type: none"> 2% defined benefit formula 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 (average of the high three consecutive years' salary). Police/Fire - 2% benefits formula for first 10 years and 2.5% for all years after 10. 	<ul style="list-style-type: none"> 2% defined benefit formula 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% benefit formula for first 10 years and 2.5% for all years after 10. 	<ul style="list-style-type: none"> 2% defined benefit formula for first 10 years 2.25% for the next 10 years, and 2.5% per year thereafter (benefit calculation is average of the high five consecutive years' salary). Police/Fire - 2% benefit formula for first 10 years and 2.5% for all years after 10 (benefit calculation is three consecutive years regardless of tier (effective 2002). 	<ul style="list-style-type: none"> 8.25% employer contribution broken out as: <ul style="list-style-type: none"> 4.25% to employee retirement savings account 1.75% to retiree medical plan 2.00% to Health Reimbursement Account
<ul style="list-style-type: none"> Medical coverage is provided to all benefit recipients and their eligible dependents. The retiree medical plan premium is paid by the retirement system. 	<p>Medical coverage is provided to disabled members, regardless of age and benefit recipients over age 60 or</p> <ul style="list-style-type: none"> police/fire members with 25 years of police/fire service all other members with 30 years of membership service <p>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.</p>	<p>Medical same as Tier II.</p> <ul style="list-style-type: none"> Except, 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. 	<ul style="list-style-type: none"> Employees must retire directly from the system with a minimum of 10 years of service to be eligible for medical plan and access to HRA Early retirees get "access" to retiree medical plan but must pay full premium until they reach age of Medicare eligibility Once reaching Medicare age eligibility, retiree pays only a portion of monthly premium based on years of service <ul style="list-style-type: none"> 10-14 years = Retiree pays 30% of premium 15-19 years = Retiree pays 25% of premium 20-24 years = Retiree pays 20% of premium 25-29 years = Retiree pays 15% of premium 30+ years = Retiree pays 10% of premium
<ul style="list-style-type: none"> The automatic PRPA legislated in 1986 applied to all members regardless of hire date. COLA of 10% of base benefit is payable to benefit recipients who remain domiciled in Alaska after retirement 	<ul style="list-style-type: none"> Automatic PRPA adjustments to disabled members, retirees 60 and over, and those who have received benefits for 5 years. COLA of 10% of base benefit is payable to benefit recipients 65 or older or disability benefit recipients regardless of age who remain domiciled in Alaska after retirement. 	<ul style="list-style-type: none"> Automatic PRPA adjustments to disabled members, retirees 60 and over, and those who have received benefits for 5 years. COLA 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

<p style="text-align: center;">TRs Tier I 7/1/55 - 6/30/90</p>	<p style="text-align: center;">TRs Tier II Entered on or after 7/1/90</p>	<p style="text-align: center;">SB 141 Proposed DC Plan Entered on or after 7/1/2006</p>
<p>Employee Pre-tax Contribution: 8.65% beginning 1/1/91</p>	<p>Employee Pre-tax Contribution: 8.65% beginning 1/1/91</p>	<p>Employee Pre-tax Contribution: 8.0 % beginning 7/1/2005</p>
<p>Members vest with 8 years of service.</p>	<p>Members vest with 8 years of service.</p>	<ul style="list-style-type: none"> • Employee is immediately vested in their own contributions • Employee's gradually vest in employer contributions <ul style="list-style-type: none"> • 25% after two years • 50% after three years • 75% after four years • 100% after five years
<ul style="list-style-type: none"> • Normal retirement age is 55 • Early retirement at age 50 • Teachers can retire at any age after 20 years of membership service. 	<ul style="list-style-type: none"> • Normal retirement age is 60 • Early retirement at age 55 • Teachers can retire at any age after 20 years 	<ul style="list-style-type: none"> • Retirement Savings: Employee can terminate at any age and take vested account balance with them, leave it in the plan or rollover to another qualified plan. • Medical Benefits: Member is eligible for benefits if: <ul style="list-style-type: none"> • 65 years of age and at least 10 years of service; or • 30 years of service
<ul style="list-style-type: none"> • 2% defined benefits formula 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. 	<ul style="list-style-type: none"> • 2% defined benefit formula for the first 20 years • 2.5% thereafter. Benefit calculation is determined on the average of the high three contract salaries. 	<ul style="list-style-type: none"> • 8.25% employer contribution broken out as: <ul style="list-style-type: none"> • 4.25% to employee retirement savings account • 1.75% to retiree medical plan • 2.00% to Health Reimbursement Account
<ul style="list-style-type: none"> • Medical coverage is provided to all benefit recipients and their eligible dependents. 	<ul style="list-style-type: none"> • Medical premiums are paid for all disabilities regardless of age and • Retirees and survivors over age 60 and for retirees with at least 25 years of service including 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. 	<ul style="list-style-type: none"> • Employees must retire directly from the system with a minimum of 10 years of service to be eligible for medical plan and access to HRA • Early retirees get "access" to retiree medical plan but must pay full premium until they reach age of Medicare eligibility • Once reaching Medicare age eligibility, retiree pays only a portion of monthly premium based on years of service <ul style="list-style-type: none"> • 10-14 years = Retiree pays 30% of premium • 15-19 years = Retiree pays 25% of premium • 20-24 years = Retiree pays 20% of premium • 25-29 years = Retiree pays 15% of premium • 30+ years = Retiree pays 10% of premium
<ul style="list-style-type: none"> • Automatic PRPA legislated in 1990 applied to all members regardless of hire date. • COLA is payable to recipients who remain domiciled in Alaska after retirement. COLA is 10% of the base benefit. 	<ul style="list-style-type: none"> • Automatic PRPA adjustments to disabled members, retirees 60 and over, and those who have received benefits for 8 years. • COLA is payable to recipients 65 or older or disability benefit recipients regardless of age who remain domiciled in Alaska after retirement. COLA is 10% of base benefit 	<p>None</p>

SB 141 Bill Version Comparison

	Senate Bill 141 DC Plan	Changes contained in CS for Senate Bill 141(FIN)	Page, Line (or Sec.)	Changes contained in HCS for Senate Bill 141(STA)	Page, Line (or Sec.)
DC RETIREMENT ACCOUNT					
Benefit Formula	11.5% per year to DC account + investment earnings.	Increased employer contribution by 1% for a total (employee + employer) contribution of 12.5%.	P 16, L 8 and P 82, L 6		
Rollover	Rollover accepted from qualified programs and you can roll over into a qualified program				
CONTRIBUTION DETAILS					
Employee Contribution Rates	DC Plan: 8% all members (PERS & TRS) DB Plan: TRS 8.65% or 1/2 of the normal cost rate. PERS: 6.75% and 7.5% (Police/Fire) or 1/2 of the normal cost rate. Maximum increase of 5% per year.	DB Plan: Changed maximum increase to 50 basis points per year (.5%).	P 7, L 30 and P 69, L 13	DB Plan: All changes eliminated. Existing employee contribution rates remain unchanged.	
Employer Contribution Rates	DB Plan: 50% of normal cost plus past service cost. May not be less than total normal cost after subtracting the member contribution.			DB Plan: Employer cost is the difference between the actuarially calculated cost (normal rate + past service rate) less the member contribution rate, but may not be less than 11% for TRS and 10% for PERS.	P 7-8, Sec. 9 and P 72, Sec. 94
	DC Plan: 8.25% total. + 3.50% to DC account + 3.75% to Medical + 1.00% to HRA <hr/> 8.25% Total	DC Plan: Redistributed 8.25% employer contribution: + 4.50% to DC account + 1.75% to Medical + 2.00% to HRA <hr/> 8.25% Total	P 16, Ls 8&10 and P 82, Ls 6&8; P 58, L 10	DC Plan: Increased contribution for medical by 2% (3.75% TRS, 3.5% PERS). New total: + 4.50% to DC account + 3.75% to Medical + 2.00% to HRA <hr/> 10.25% Total TRS 10.00% Total PERS	P16, L 12 and P 83, L 22

SB 141 Bill Version Comparison

	Senate Bill 141 DC Plan	Changes contained in CS for Senate Bill 141(FIN)	Page, Line (or Sec.)	Changes contained in HCS for Senate Bill 141(STA)	Page, Line (or Sec.)
VESTING DETAILS					
Vesting	Immediate for employee contributions. Fully vested in employer contributions after 5 years (1st year 0%, 2nd yr 25%, 3rd yr 50%, 4th yr 75%, 5th yr 100%)				
MEDICAL PROGRAM					
Medical Benefits	Must retire directly from system with minimum of 10 years of service for medical coverage and access to HRA.	Removed requirement to "retire from system" and added option to defer participation to a date specified.	P 16, L 3 and P 92, L 1	Restored requirement to retire directly from system with minimum of 10 years of service for medical coverage.	P 26, Ls 5-18 and P 93, Ls 15-28
	Access to medical coverage at Medicare eligible age (currently 65) with 10 years of service, or at any age after (1) 25 years for peace officer/firefighter, or (2) 30 years for all others.			Access to medical coverage at "normal retirement age" (60 months prior to Medicare eligible age) with 10 years of service.	P 26, Ls 23-30, and P 93, Ls 15-28
	Retiree share of medical premium at Medicare eligible age based on years of service: + 10-14 years = 30% + 15-19 years = 25% + 20-24 years = 20% + 25-29 years = 15% => 30 years = 10%			Upon reaching normal retirement age, employer subsidy of medical premium is 30% for 10 years of service, incremented by 3% each year. Maximum subsidy is 90% for 30 years or more. The only thing that changes at Medicare eligibility is the subsidy base premium dollar amount.	P 27, L 30 thru P 28, Ls 1-6 and P 95, Ls 9-16
	Retiree and survivors pay full premium until Medicare eligible.			"Early retirees" (meets service but not age requirements) and survivors pay full premium until normal retirement age.	P 27, Ls 28-29 and P 95, Ls 7-8

SB 141 Bill Version Comparison

	Senate Bill 141 DC Plan	Changes contained in CS for Senate Bill 141(FIN)	Page, Line (or Sec.)	Changes contained in HCS for Senate Bill 141(STA)	Page, Line (or Sec.)
				Added a limitation on dependent medical coverage: if a spouse or dependent child was not the spouse or dependent child of an eligible member when that person was an active member, they do not qualify for coverage.	P 27, Ls 8-11 and P 94, Ls 18-21
Health Reimbursement Arrangement (HRA)	Retiree reimbursed for qualified medical expenses from HRA.	Clarified HRA can be used even if not participating in State's medical insurance plan.	P 26, Ls 13-14	A person is eligible to apply for reimbursement from the HRA if they have met the eligibility requirements (AS 14.25.470 or AS 39.35.870), except the person does <i>not</i> have to retire directly from the system.	P 59, Ls 28-31
	Employer contributes 1% of employer's average annual group compensation	Employer contributes 2% of annual average employer's group compensation	P 58, L 10		
		Changed five-year return requirement from "same" employer to "a participating" employer.	P 58, L 19	Removed five-year return window and added accumulated interest during intervening time to restored account balance.	P 59, Ls 24-27
RETIREMENT BOARDS					
Board Structure	Consolidates 3 existing boards (PERS, TRS, ASPIB) into 1 board (Alaska Retirement Management Board [ARMB]).	Added transition: ASPIB continues until 9/30/05; ARMB effective 10/1/2005	P 106, Sec. 134 and Sec. 135		

SB 141 Bill Version Comparison

	Senate Bill 141 DC Plan	Changes contained in CS for Senate Bill 141(FIN)	Page, Line (or Sec.)	Changes contained in HCS for Senate Bill 141(STA)	Page, Line (or Sec.)
Board Members	All trustees must have recognized competence in one or more fields of investment management, finance, banking, economics, accounting, pension administration, or actuarial analysis. Includes non-beneficiaries and representatives from school districts and municipalities.	Added definition of "recognized competence" as a person with at least 10 years working or teaching in the specified fields.	P 51, Ls 6-9	Changed trustees to: 3 appointed by Governor (only one a non-participant) and 4 elected (2 PERS, 2 TRS). Elections conducted by ARMB Board. Removed requirement that <i>all</i> members have "recognized competence" in specified fields; only required of Governor appointees.	P 47, L 11 thru P 48 L 5
	Appointed trustees must be eligible for an Alaska Permanent Fund Dividend.			Lost PFD eligibility requirement for elected board members.	
Board Terms	Three year terms, maximum of three consecutive terms. One year break required.			Six year terms, maximum of two consecutive terms. One year break required.	P 48, Ls 6-9
Board Duties	ARMB assumes prior duties of ASPIE plus coordinates with retirement system administrator on annual actuarial valuations, sets employer contribution rates, and determines interest rates to be credited to members' individual accounts (DB plan and HRA).	Added a requirement for the Board to require a second actuarial opinion on the assumptions used in the valuation by the State's primary actuary.	P 107, Sec. 138		
		Added direction to the new Board to prepare a report for the 2nd session of the 24th Alaska Legislature.	P 49, Ls 4-6		
Office of Administrative Hearings (OAH)	Appeals of benefits decisions made by the retirement system administrator transferred to the OAH, an independent quasi-judicial agency.				

SB 141 Bill Version Comparison

	Senate Bill 141 DC Plan	Changes contained in CS for Senate Bill 141(FIN)	Page, Line (or Sec.)	Changes contained in HCS for Senate Bill 141(STA)	Page, Line (or Sec.)
CHANGES TO EXISTING RETIREMENT PLANS					
AK Resident COLA	Repeals	Reinstated			
Ad hoc PRPAs		Defined "financial condition of the retirement fund" for ad hoc PRPAs as 110% ratio of assets to liabilities (see Editor's notes under AS 14.25.143 & AS 39.35.483)	P 11 Sec. 17, P 11 Sec. 18, and P 77 Sec. 113		
Refunded Prior Members	Closes window for reinstating past service indebtedness.				
University of Alaska Optional Retirement Program		Changed AS 14.40.661-14.40.799 giving the Board of Regents flexibility to design both optional and mandatory retirement programs for future University employees. Specifies the University's retirement programs are not subject to collective bargaining. Also provides a one-time option for current employees who chose to participate in PERS or TRS to transfer into the existing optional retirement program.	P 38, Sec. 35 thru P 42, Sec. 51		

SB 141 Bill Version Comparison

	Senate Bill 141 DC Plan	Changes contained in CS for Senate Bill 141(FIN)	Page, Line (or Sec.)	Changes contained in HCS for Senate Bill 141(STA)	Page, Line (or Sec.)
OTHER BILL COMPONENTS					
Transfer of Employee to DC Plan		Added option for the transfer of current non-vested (TRS Tier II and FERS Tier III) employees to the DC plan. Unlimited enrollment period. Employer must make new contribution (cannot take from DB trust) and has first option to allow a transfer.	P 30, L 2 and P 96, L 1		
Participating Employers		Added an option for political subdivisions and public organizations who do not currently participate in PERS and TRS to join the DC plan in the future.	P 98, Ls 9-22		
		Added specific employers already participating in PERS and TRS to allow their future employees to participate in the DC plan (defined benefit plans closed on July 1, 2005).	P 32, L 20 thru P 33, L 28 and P 93, Ls 2-17		
Membership Service		Added language identical to current statutes that prevents members that participate in both PERS and TRS from claiming more than one year of service (ex., a full-time teacher in TRS that works part-time in a PERS position during summer).	P 32, L 10 and P 98, L 23		

SB 141 Bill Version Comparison

	Senate Bill 141 DC Plan	Changes contained in CS for Senate Bill 141(FIN)	Page, Line (or Sec.)	Changes contained in HCS for Senate Bill 141(STA)	Page, Line (or Sec.)
Penalty for False Statements AS 14.25.210				Removed the existing language that a person who knowingly makes a false statement "forfeits all rights under this chapter". Language conforms to PERS AS 39.35.670.	P 13, Sec. 25
Definition of "teacher" AS 14.25.220 (DB plan) and AS 14.25.590 (DC plan)				Adds AVTEC instructors to the definition of "teacher" and "member" for participation in TRS regardless of whether the position requires a certificate if the instructor is certified.	P 14, Sec. 30, Ls 16-20
Legislative Intent				Added intent language in Sec. 1 that R&B implement by regulation cost-saving measures in the retiree health care system and gives examples.	P 2, Sec. 1
				Requires annual report to legislature by R&B on implementation of cost-saving measures.	P 110, Sec. 139

KEY:

Changes made in House State Affairs

(Proposed Amendments)

Walkthrough House State Affairs CS to SB141

The language for this document was taken from CSSB 141 Walkthrough provided by SB 141 sponsors. Applicable changes were made to existing document with with some rearranging of sections.

Changes to Existing Retirement System

■ Ad-hoc Post Retirement Pension Adjustments *Sec. 16 (pg 10), Sec. 17 (pg 11), Sec. 111 (pg77)*

Defines "financial condition of the retirement fund" for the ad-hoc post retirement pension adjustment as a 110% ratio of assets to liabilities applicable only to tier 1 retirees). (See editor's notes under AS14.25.143 and AS 39.35.483)

Changes to the Board

■ Consolidation of Boards

• Eliminates:

- Public Employees' Retirement System Board.
- Teachers Retirement System Board.
- Alaska State Pension Investment Board.

• Creates new Alaska Retirement Management Board (ARM Board) *Sec. 59 (pg 46)*

◦ 3 trustees appointed by the Governor

- Commissioner of Administration
- Commissioner of Revenue

◦ 1 Alaska resident who does not participate in the retirement system

◦ 1 finance officer of a political subdivision

◦ 1 finance officer of a school district

◦ 2 PERS members (active or retired)

◦ 2 TRS members (active or retired)

◦ PERS & TRS members are elected by their member groups

** (PERS & TRS members are appointed by the governor from a selection of nominees put forward by the appropriate bargaining units.) **

• All appointed trustees must have recognized competence (working or teaching) in one or more of the fields of investment management, finance, banking, economics, accounting, pension administration, or actuarial analysis.

• Terms

◦ Staggered three years

◦ limited to two consecutive terms with a required one-year break

◦ 6 year term limits

■ Powers and duties of the ARM board *Sec. 61 (pg49-52)*

• Manage the assets and set the investment objectives of the defined benefit trust fund to met pension liabilities.

• Annual actuarial valuation of system plans, coordinating with the retirement system administrator.

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on file 4/30/05

KEY:Changes made in House State Affairs
(Proposed Amendments)

- Analysis of actuarial assumptions experience, including a second opinion:
 - Health costs assumptions annually.
 - All other assumptions not less than every four years.
- Audit of actuary not less than every four years.

Medical Program Elements**■ Required Contribution by Employer for Major Medical Plan 14.25.350(b) (pg 16), 39.750(b) (pg 83)**

- 3.75% of employee compensation for TRS
- 3.5% of employee compensation for PERS
- ** (2.5% of employee compensation) **
- Contribution is made to group health and life insurance trust fund to be used for employee's share of retiree's monthly medical premiums

■ Eligibility 14.25.470 (pg 26) 39.35.870 (pg 93)

- A member is eligible to elect medical benefits if the member:
 - is age 60 months pre-Medicare eligible and has at least 10 years of service and retires directly from the system or
 - has 30 years of service
 - ** (has 25 years of service as a peace officer/fire fighter) **
- A member's spouse and dependents are eligible for benefits if they were dependents during the member's active service.

■ Benefits 14.25.480 (pg 26) 39.35.880 (pg 93)

- Medical benefits include access to a major medical insurance and the health reimbursement arrangement (HRA).
- Access means that an eligible person may not be denied insurance coverage except for failure to apply the required premium.
- An eligible person may participate in the medical insurance, the HRA, or both.
- An irrevocable decision to elect major medical insurance must be made by age 70.5.

■ Major Medical Insurance 14.25.480 (pg 26) 39.35.880 (pg 92)

- Insurance coverage for an eligible member includes the member's spouse and the member's dependent children.
- Insurance coverage for a surviving spouse includes the member's dependent children if they are dependent on the surviving spouse.
- Each participant shall pay a separate premium amount with the subsidy based on the member's years of service.
- Retirees who met the required years of service, but who are less than 60-months pre-Medicare eligible (presently age 60), must pay the full premium to receive coverage.
- Retirees who are 60 months pre-Medicare eligible will pay only a portion of a monthly medical premium based on years of service. The percentage subsidy

KEY:

Changes made in House State Affairs
(Proposed Amendments)

from the plan applied to the premium is determined by using a subsidy base that increases by no more than 5% per year.

◦The percentage subsidy is 30% for 10 years of service, incrementing by 3% for each additional year of service until the member has 30 years of service, or a 90% subsidy.

** (Retirees who are Medicare age eligible will pay only a portion of monthly medical premiums depending on years of service:

- 10-14 years = 30%
- 15-19 years = 25%
- 20-24 years = 20%
- 25-29 years = 15%
- 30+ years = 10%**

■ Health Reimbursement Arrangement (HRA) 39.30.300 (pg 58)

• Employer Fund

◦The HRA Trust is an employer owned fund. 39.30.350 (pg 59)

◦Employee contributions are not permitted

◦Employers may use surplus funds held in the trust to credit individual employee records with the annual contributions owed by the employer.

■ Required Contributions 39.30.370 (pg 59)

• Employer contributes an annual (and equal) dollar amount per employee to the health insurance trust fund.

• Amount is 2% of employer's annual average group compensation

** (Amount is 3% of employer's annual average group compensation)**

◦Contribution is recorded in both an individual employee account and an employer record.

• interest is posted to individual accounts annually, the rate determined by the ARMB

• Contributions and interest accumulate over working lifetime of employees.

■ Termination of Employment 39.30.380 (pg 59)

• individual accounts are maintained for an indefinite period of time.

• A person who returns to work is attributed the account balance recorded in their name on the date of termination plus any accumulated interest or adjustments.

■ Reimbursements

• Who is eligible

◦Persons who meet the eligibility requirements for medical benefits

◦Dependent children are eligible if both retiree and spouse die

◦A person may vest in their HRA after 10 years of service and have access to it upon reaching normal retirement age regardless of whether or not that member retires directly from the system.

• Reimbursements made for qualified medical expenses under IRC 213(d), including medical premium payments. 39.30.400 (pg 60).

• Total reimbursements are limited to individual's recorded account.

KEY:

Changes made in House State Affairs
(Proposed Amendments)

- no set limits other than exhaustion of account balance.

Defined Contribution (DC) Plan Elements

■ Required Contributions

- Employee: 8% of compensation, deducted pre-tax by employer. *14.25.340(a) (pg 15), 39.35.730(a) (pg 82).*
- Employer: 4.5% of employee compensation.
- Total individual account contributions: 12.5%.

■ Optional Contributions

- A member may elect to contribute additional earnings not to exceed the limits established by the Internal Revenue Code. *14.25.340 (pg 15), 39.35.730 (pg 82)*

■ Rollovers *14.25.360 (pg 16), 39.35.760 (pg 83)*

- Employees can take their individual account with them when they leave employment.
- Employees can "roll" in other qualified funds when they are hired.

■ Vesting *14.25.390 (pg 180), 39.35.790 (pg 85)*

- All members of the DC plan are immediately vested in their own contributions and related earnings.
- Members are gradually vested in the employer contributions and related earnings on the following schedule:
 - 25% after two years;
 - 50% after three years;
 - 75% after four years;
 - 100% after five years.

■ Investment Accounts *14.25.400 (pg 18), 39.35.800 (pg 85)*

- The Alaska Retirement Management Board will provide a range of investment options.
- Participants direct the investment of their funds.

■ Distribution of Accounts *14.25.410 (pg 19) – 14.25.440 (pg 22), 39.35.810 (pg 86) – 39.35.840 (pg 89)*

- Employee may elect a distribution upon termination of employment, after 60 days.
- Subject to IRC regulations
- May receive funds prior to 60 days for financial hardship.
- Rate setting:
 - Employer contribution rate, including "normal cost" and "past service cost".
 - Employee contribution rates if one-half of the "normal cost is higher than the current rates set in statute.

KEY:

Changes made in House State Affairs
(Proposed Amendments)

- Interest rates credited to individual employee accounts.
- Interest rates credited to employee HRA account recorded.
- Provide a range of investment options for all employees-directed accounts.

- Other Duties of the former PERS and TPS Boards Transferred
 - To the Commissioner of Administration:
 - Adoption of regulations governing the retirement system.
14.25.006 (pg 5), 39.35.006 (pg 65), Sec. 129 (pg 107)
 - Requests for a waiver of any adjustment made to the retirement system accounts due to a change or error in contributions or benefits computations. *Sec. 21-23 (pg 13)*
 - to the Office of Administrative Hearings:
 - Adjudication of appeals related to decision of the retirement system administrator. *14.25.006 (pg 5), 39.35.006 (pg 64), Sec. 129 (pg 107)*
 - Adjudication of appeals related to the denial of a waiver for repayment of overpayments. *Sec. 24-25 (pg 12-13)*

- Conditional Service Retirement Benefits *Sec. 111 (pg 77)*
 - Changes the credited service requirement to 120 days for legislative employees under AS 39.35.385(f).

- Repeal
 - Refunded prior members *Sec. 131 (pg 107) <AS 14.25.062 and AS 39.35.350>*
 - Repealed effective June 30, 2010.
 - The intent of the repeal is to relieve the "off books" liability of hundreds of millions of dollars represented by more than 77,000 people who have refunded out of the State's retirement system but who could return to work and be restored to the tier status they held prior to terminating by repaying the amount refunded plus interest.
 - In medical premiums alone, this amount stands at greater than \$107 million for one year in today's dollars.

- Fiscal Note
 - Appropriates \$69.5 million directly to the retirement trust funds on behalf of all PERS participating employers (includes small amount of TRS). This amount represents the 5% increase in PERS employer costs from FY2005 to FY2006.
 - PERS and TRS for school districts (\$38.1) is rolled into the BSA at \$4,919.

Other Plan Elements

- Option to Convert from BD to DC Plan *14.25.540 (pg 30), 39.35.940 (pg 97)*
 - Unvested, active members of PERS and TRS are eligible to convert to DC plan.
 - Employer must first make the choice to offer this option to all their employees.

KEY:

Changes made in House State Affairs
(Proposed Amendments)

- Participation in DC plan is in lieu of the DB plan; all rights to DB plan are forfeit.
- A member's individual account balance will be rolled into a new account under the DC plan.
- A member's employer shall make a 100% matching contribution with new funds (i.e., cannot transfer employer portion from the DB trust fund).
- A member's years of service under the DB plan will be counted towards the years of service required for medical benefits eligibility.

■ **Participating Employers**

- Mechanism is included for political subdivisions and public organizations that do not currently participate in PERS to join the DC plan in the future. 39.35.950-39.35.955 (pg 100)
- Includes specific employers already participating in PERS and TRS to allow their future employees to participate in the DC Plan (DB plan closes on July 1, 2005). 14.25.560-14.25.580 (pg 33), 39.35.965-39.35.970 (pg 100-101)
 - Legislators who have been teachers
 - National Education Association employees
 - Special Education Service Agency employees
 - Army and Air National Guard employees
 - North Pacific Fishery Management Council employees

State of Alaska

Division of Retirement & Benefits

Normal Cost Rate and Actuarial Computed Rate from FY 1983 through FY 2006

<u>Valuation report date June 30</u>	<u>Fiscal year of rate</u>	<u>Normal Cost rate PERS</u>	<u>Actuarial Computed Rate PERS</u>	<u>Normal Cost rate TRS</u>	<u>Actuarial Computed Rate TRS</u>
1980	1983	11.46%	13.78%	11.95%	16.84%
1981	1984	12.03%	13.68%	13.51%	17.42%
1982	1985	11.36%	13.62%	13.64%	17.96%
1983	1986	11.82%	13.59%	13.13%	17.36%
1984	1987	12.31%	13.84%	13.91%	13.28%
1985	1988	11.13%	9.55%	11.62%	13.28%
1986	1989	10.20%	9.38%	9.36%	11.16%
1987	1990	9.23%	9.30%	9.14%	8.19%
1988	1991	10.37%	12.00%	11.86%	12.27%
1989	1992	12.00%	14.20%	13.26%	15.16%
1990	1993	12.83%	13.58%	14.07%	19.65%
1991	1994	10.18%	13.72%	9.05%	15.59%
1992	1995	10.90%	13.70%	8.57%	13.36%
1993	1996	11.29%	12.82%	9.06%	12.48%
1994	1997	10.36%	12.14%	9.70%	14.96%
1995	1998	10.61%	11.90%	10.10%	14.94%
1996	1999	9.85%	7.74%	8.97%	10.52%
1997	2000	9.89%	7.36%	9.21%	13.00%
1998	2001	8.67%	7.03%	8.99%	10.55%
1999	2002	8.07%	6.56%	8.88%	7.09%
2000	2003	10.07%	6.12%	9.40%	8.29%
2001	2004	9.53%	6.77%	10.36%	14.44%
2002	2005	13.31%	24.91%	14.76%	35.57%
2003	2006	13.24%	25.63%	14.28%	38.85%

Normal Cost Rate: present value of benefits, which are expected to be credited with respect to service during the year beginning on the valuation date.

Actuarial Computed Rate: after comparing plan assets and liabilities, an actuarial rate is computed that would fully fund the retirement systems over 25 years. There are two components: the normal cost rate and the past service rate necessary to pay any unfunded liability. Both rates account for differences between actual experience versus anticipated results, changes in actuarial assumptions and / or methods, changes in statutory provisions, and the difference between the rate actually adopted by the Boards for a particular year versus the computed rate.

5 year average PERS 10.84% 5 year average TRS 11.54%
 24 year average PERS 10.86% 24 year average TRS 11.11%
 Page 24

Hi Katie:

I wanted to let you know that Mercer has costed the medical benefits for House CS for CS for Senate Bill No. 141 (STA)

Mercer states, "we have analyzed the expected liabilities associated with the new tier described in House Bill 238 medical provisions. The analysis is based on the following:

- Coverage is available only to members who retire from the System at normal retirement (age 60 with 10 years of service) or after 30 years of service.
- Members or their spouses who are less than age 60 pay the full cost for their coverage.
- Upon reaching age 60, members (or their spouses) are eligible for System-subsidized medical coverage. They will receive a defined subsidy amount based on Medicare eligibility status and service duration (3% per year of service, up to 30 years). Based on these provisions we estimate that the current normal cost rate (as a percentage of total payroll) will be 1.0% for TRS and 1.1% for PERS."

It took longer because I asked Mercer to run the models again. Please let me know if you have any questions. Thanks.

--
Melanie Millhorn, Director

State of Alaska

Department of Administration - Division of Retirement & Benefits

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PERS (SB 141)

**8% employee and 4.5% employer contribution = 12.5% DC account
Projected Benefits – Rate of Return 8.25%**

FEMALE			
Number of years worked	DC account lump sum at termination	Beginning annuity in 2004 dollars	% funded compared to current DB plan
10	\$68,664	\$3,742	67%
20	\$243,985	\$9,220	88%
30	\$663,081	\$17,374	114%

MALE			
Number of years worked	DC account lump sum at termination	Beginning annuity in 2004 dollars	% funded compared to current DB plan
10	\$68,664	\$4,057	72%
20	\$243,985	\$9,995	95%
30	\$663,081	\$18,834	123%

Assumptions:

Beginning Salary 32,000

Defined Contribution pension account percentage 12.5%

Anchorage CPI 3.73%

Real rate of interest 4.52%

Salary increase 3%

Based on 2000 mortality table (Mercer's projections are based on a 1994 mortality table)

Employer contribution to DC account	4.5%
Employer contribution to Medical Plan	2.5%
Employer contribution to HRA	3%
Total Employer contribution	10%
24 year average employer contribution	10.9% - 11.1%
5 year average employer contribution	10.8% - 11.5%

CORRECTION

THE FOLLOWING DOCUMENT(S)
HAVE BEEN REFILMED TO
ASSURE LEGIBILITY OR PAGINATION



Central Microfilm Services
Department of Education & Early Development
State of Alaska

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Mercer states, "we have analyzed the expected liabilities associated with the new tier described in House Bill 238 medical provisions. The analysis is based on the following:

- * Coverage is available only to members who retire from the System at normal retirement (age 60 with 10 years of service) or after 30 years of service.
- * Members or their spouses who are less than age 60 pay the full cost for their coverage.
- * Upon reaching age 60, members (or their spouses) are eligible for System-subsidized medical coverage. They will receive a defined subsidy amount based on Medicare eligibility status and service duration (3% per year of service, up to 30 years). Based on these provisions we estimate that the current normal cost rate (as a percentage of total payroll) will be 1.0% for TRS and 1.1% for PERS."

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Cost to retiree hired today pre-Medicare eligible (each yr)	SFIN SB 141	HSTA SB 141
10 yrs service, age 64	\$15,122	\$11,518
20 yrs service, age 64	\$24,633	\$13,096
30 yrs service, age 64	\$40,124	\$11,936
Cost to retiree hired today Post-Medicare eligible (each yr)		
10 yrs service, age 65	\$2,331	\$5,439
20 yrs service, age 65	\$2,531	\$6,759
30 yrs service, age 65	\$2,062	\$6,205

PERS (SB 141)

**8% employee and 4.5% employer contribution = 12.5% DC account
Projected Benefits – Rate of Return 8.25%**

FEMALE			
Number of years worked	DC account lump sum at termination	Beginning annuity in 2004 dollars	% funded compared to current DB plan
10	\$68,664	\$3,742	67%
20	\$243,985	\$9,220	88%
30	\$663,081	\$17,374	114%

MALE			
Number of years worked	DC account lump sum at termination	Beginning annuity in 2004 dollars	% funded compared to current DB plan
10	\$68,664	\$4,057	72%
20	\$243,985	\$9,995	95%
30	\$663,081	\$18,834	123%

Assumptions:

Beginning Salary 32,000

Defined Contribution pension account percentage 12.5%

Anchorage CPI 3.73%

Real rate of interest 4.52%

Salary increase 3%

Based on 2000 mortality table (Mercer's projections are based on a 1994 mortality table)

Employer contribution to DC account	4.5%
Employer contribution to Medical Plan	2.5%
Employer contribution to HRA	3%
Total Employer contribution	10%
24 year average employer contribution	10.9% - 11.1%
5 year average employer contribution	10.8% - 11.5%

TRS (SB 141)

**8% employee and 4.5% employer contribution = 12.5% in DC account
Projected Benefits – Rate of Return 8.25%**

FEMALE			
Number of years worked	DC account lump sum at termination	Beginning annuity in 2004 dollars	% funded compared to current DB plan
10	80,547	4,390	67%
20	286,210	10,816	88%
30	777,835	20,380	109%

MALE			
Number of years worked	DC account lump sum at termination	Beginning annuity in 2004 dollars	% funded compared to current DB plan
10	80,547	4,759	72%
20	286,210	11,725	95%
30	777,835	22,094	119%

Assumptions:

Beginning Salary 37,538

Defined Contribution pension account percentage 12.5%

Anchorage CPI 3.73%

Real rate of interest 4.52%

Salary increase 3%

Based on 2000 mortality table (Mercer's projections are based on a 1994 mortality table)

Employer contribution to DC account	4.5%
Employer contribution to Medical Plan	2.5%
Employer contribution to HRA	3%
Total Employer contribution	10%
24 year average employer contribution	10.9% - 11.1%
5 year average employer contribution	10.8% - 11.5%

TRS (Alternative)

**8% employee and 5% employer contribution = 13% in DC account
Projected Benefits – Rate of Return 8.25%**

FEMALE			
Number of years worked	DC account lump sum at termination	Beginning annuity in 2004 dollars	% funded compared to current DB plan
10	\$83,769	\$4,566	69%
20	\$297,658	\$11,248	92%
30	\$808,948	\$21,196	114%

MALE			
Number of years worked	DC account lump sum at termination	Beginning annuity in 2004 dollars	% funded compared to current DB plan
10	\$83,769	\$4,949	75%
20	\$297,658	\$12,194	99%
30	\$808,948	\$22,978	123%

Assumptions:

Beginning Salary 37,538

Defined Contribution pension account percentage 13%

Anchorage CPI 3.73%

Real rate of interest 4.52%

Salary increase 3%

Based on 2000 mortality table (Mercer's projections are based on a 1994 mortality table)

Employer contribution to DC account	5%
Employer contribution to Medical Plan	2.5%
Employer contribution to HRA	3%
Total Employer contribution	10.5%
24 year average employer contribution	10.9% - 11.1%
5 year average employer contribution	10.8% - 11.5%

PERS (Amendment)

**8% employee and 5% employer contribution = 13.5% in DC account
Projected Benefits – Rate of Return 8.25%**

FEMALE			
Number of years worked	DC account lump sum at termination	Beginning annuity in 2004 dollars	% funded compared to current DB plan
10	\$71,410	\$3,892	69%
20	\$253,745	\$9,589	92%
30	\$689,604	\$18,069	118%

MALE			
Number of years worked	DC account lump sum at termination	Beginning annuity in 2004 dollars	% funded compared to current DB plan
10	\$71,410	\$4,219	75%
20	\$253,745	\$10,395	99%
30	\$689,604	\$19,588	128%

Assumptions:

Beginning Salary 32,000

Defined Contribution pension account percentage 13%

Anchorage CPI 3.73%

Real rate of interest 4.52%

Salary increase 3%

Based on 2000 mortality table (Mercer's projections are based on a 1994 mortality table)

Employer contribution to DC account	5%
Employer contribution to Medical Plan	2.5%
Employer contribution to HRA	3%
Total Employer contribution	10.5%
24 year average employer contribution	10.9% - 11.1%
5 year average employer contribution	10.8% - 11.5%

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REPRESENTATIVE Paul Seaton

District 35

April 27, 2005

Committee Members,

During Saturday's House Finance meeting Representative Hawker requested the dollar amount increase of the medical benefits in SB141 as amended by House State Affairs. The medical benefit in SB 141 as it came to House State Affairs was system subsidized medical insurance only for post-Medicare eligible age (currently age 65). House State Affairs changed the medical component to a plan based on Mercer's tier proposal the committee had been working on for weeks that provides medical benefits 60-months pre-Medicare eligible age (currently age 60). This required an increase in employer contribution of 2% (TRS) and 1.75% (PERS) bringing the employer contribution rate for medical coverage up from 1.75% in SB 141 to 3.75% (TRS) and 3.5% (PERS). For fiscal year 2007 this represents a total increase of \$37,918,353, or \$11,122,649 for TRS and \$26,795,704 for PERS (see table bellow). These numbers are based on Mecer's projections, which assumes a 1% annual employee population growth (enclosure).

	FY07 dollar amount	% of Salary
Total employer normal cost in SB 141 (PERS+TRS)	172,203,531	8.25
Total Employer normal cost in House STA CSSB 141 (PERS+TRS)	210,121,884	10 PERS 10.25 TRS
Difference between the two	26,795,704	1.75 PERS 2 TRS

It is important to note that the figures adopted by House State Affairs reflect the Mercer tier study. In fact, a slight additional cost savings can be expected because both the pre and post-Medicare medical plan include a cost sharing of health care inflation. This means that the plan does not subject itself to another possible unfunded liability if health care was to increase more than actuarially predicted. A plan without cost-basis adjustment could be greatly impacted if federal Medicare rates or coverage change and leave the State's plan holding the bag for unanticipated coverage.

I would also like to emphasis that the total employer contribution rate (including pension and medical contributions) under the House State Affairs CS to CSSB141 is 10.25% for TRS and 10% for PERS. This is less than the 24-year average normal cost rate that employers are accustomed to contributing, 11.11% for TRS and 10.86% for PERS (enclosure).

Please let me know if I can provide any additional information or assistance.

Sincerely,

A handwritten signature in cursive script that reads "Paul Seaton".

Representative Paul Seaton

State of Alaska Public Employees' Retirement System
 Projections Based on July 1, 2003 Valuation
 Population Growth 1 Percent

Valuation Year	Fiscal Year	Annual Payment To Past Service Cost (000's)*					Present Value of Past Service Cost Payments (000's)**				
		Tier 1	Tier 2	Tier 3	Tier 4	Total	Tier 1	Tier 2	Tier 3	Tier 4	Total
						9,025,483	328,745	385,141	500,233	1,660,287	2,874,406
2003	2006	-	-	-	-	-	-	-	-	-	-
2004	2007	-	-	-	-	-	-	-	-	-	-
2005	2008	17,062	17,356	21,383	5,223	61,024	13,451	13,683	16,857	4,117	48,108
2006	2009	37,866	38,986	46,758	23,097	146,707	27,576	28,392	34,052	16,821	106,841
2007	2010	56,481	59,269	70,098	53,097	238,945	37,998	39,874	47,159	35,721	160,752
2008	2011	60,548	64,671	76,335	78,725	280,279	37,630	40,192	47,441	48,926	174,189
2009	2012	58,021	63,061	75,074	98,932	295,088	33,311	36,205	43,101	56,799	169,416
2010	2013	55,292	61,191	73,799	120,062	310,344	29,325	32,454	39,140	63,677	164,596
2011	2014	52,367	58,990	72,422	142,669	326,448	25,657	28,902	35,483	69,900	159,942
2012	2015	49,239	56,745	70,815	166,451	343,250	22,286	25,683	32,052	75,337	155,358
2013	2016	45,896	54,206	69,101	191,666	360,869	19,190	22,664	28,892	80,138	150,884
2014	2017	42,451	51,531	67,178	218,188	379,348	16,397	19,904	25,947	84,275	146,523
2015	2018	38,891	48,854	65,141	245,867	398,753	13,877	17,432	23,243	87,728	142,280
2016	2019	35,178	45,472	63,011	275,138	418,799	11,595	14,988	20,770	90,690	138,043
2017	2020	31,388	41,997	60,830	305,494	439,709	9,557	12,788	18,522	93,022	133,889
2018	2021	27,647	38,426	58,610	337,093	461,776	7,777	10,809	16,486	94,821	129,893
2019	2022	23,904	35,013	55,973	369,989	484,879	6,212	9,098	14,545	96,142	125,997
2020	2023	20,393	32,052	52,542	404,164	509,151	4,895	7,694	12,613	97,019	122,221
2021	2024	17,032	29,047	48,970	439,645	534,694	3,777	6,441	10,859	97,453	118,570
2022	2025	13,998	26,096	45,306	476,267	561,667	2,867	5,346	9,281	97,565	115,059
2023	2026	11,355	23,215	41,724	513,787	590,081	2,149	4,393	7,896	97,229	111,667
2024	2027	8,953	20,489	38,132	552,345	619,919	1,565	3,582	6,666	96,560	108,373
2025	2028	6,887	17,821	34,402	589,722	648,832	1,112	2,878	5,556	95,237	104,783
2026	2029	2,192	6,473	13,174	264,403	286,242	327	966	1,965	39,445	42,703
2027	2030	1,247	4,334	9,420	220,582	235,583	172	597	1,298	30,400	32,467
2028	2031	331	1,379	3,215	88,171	93,096	42	176	409	11,225	11,852
Total		714,619	896,674	1,233,413	6,180,777	9,025,483					

* Expected employer contributions paid during fiscal year

** Expected employer contributions during fiscal year, discounted to June 30, 2003 at 8.25%

State of Alaska Public Employees' Retirement System
 Projections Based on July 1, 2003 Valuation
 Population Growth 1 Percent

Valuation Year	Fiscal Year	Number of Active Members					Projected Salaries				
		Tier 1	Tier 2	Tier 3	Tier 4	Total	Tier 1	Tier 2	Tier 3	Tier 4	Total
2003	2006	8,814	9,747	15,503	-	34,064	445,612,413	444,684,916	570,485,671	-	1,460,783,000
2004	2007	8,047	8,982	13,585	3,790	34,404	467,087,982	466,115,785	597,979,304	-	1,531,183,071
2005	2008	7,405	8,317	12,108	6,919	34,749	443,170,178	450,811,828	555,400,922	135,653,961	1,585,036,909
2006	2009	6,774	7,707	10,932	9,683	35,096	424,502,518	437,058,318	524,190,528	258,937,144	1,644,688,508
2007	2010	6,186	7,130	9,982	12,150	35,448	403,437,555	423,347,289	500,700,859	379,263,597	1,706,749,300
2008	2011	5,629	6,580	9,189	14,404	35,802	382,811,771	408,881,345	482,626,935	497,736,648	1,772,056,699
2009	2012	5,102	6,053	8,483	16,522	36,160	361,864,984	393,298,549	468,217,939	617,020,112	1,840,401,584
2010	2013	4,596	5,541	7,828	18,556	36,521	340,672,881	377,023,399	454,701,421	739,749,209	1,912,146,910
2011	2014	4,116	5,060	7,221	20,490	36,887	318,726,365	359,035,502	440,790,891	868,339,057	1,986,891,815
2012	2015	3,657	4,598	6,662	22,338	37,255	296,324,286	341,498,361	426,172,270	1,001,713,372	2,065,708,289
2013	2016	3,227	4,163	6,142	24,096	37,628	273,207,199	322,670,777	411,338,155	1,140,931,235	2,148,147,366
2014	2017	2,823	3,759	5,662	25,760	38,004	250,100,955	303,593,105	395,776,219	1,285,453,959	2,234,924,238
2015	2018	2,442	3,351	5,209	27,382	38,384	227,013,934	285,172,271	380,239,911	1,435,170,115	2,327,596,231
2016	2019	2,088	2,970	4,785	28,925	38,768	203,568,141	263,142,249	364,638,155	1,592,183,766	2,423,532,311
2017	2020	1,765	2,612	4,387	30,392	39,156	180,221,422	241,135,972	349,270,550	1,754,077,565	2,524,705,509
2018	2021	1,466	2,286	3,998	31,797	39,547	157,594,474	219,036,817	334,095,610	1,921,529,873	2,632,256,774
2019	2022	1,204	2,003	3,604	33,132	39,943	135,374,479	198,287,761	316,989,771	2,095,331,248	2,745,983,259
2020	2023	971	1,739	3,229	34,403	40,342	114,803,685	180,436,391	295,789,651	2,275,266,070	2,866,295,797
2021	2024	769	1,499	2,876	35,601	40,745	95,361,469	162,631,692	274,183,515	2,461,558,447	2,993,735,123
2022	2025	602	1,281	2,551	36,719	41,153	77,984,925	145,383,837	252,406,495	2,653,379,532	3,129,154,789
2023	2026	457	1,087	2,248	37,773	41,565	62,993,027	128,788,268	231,466,581	2,850,292,445	3,273,540,321
2024	2027	342	914	1,965	38,759	41,980	49,492,319	113,259,938	210,793,089	3,053,333,799	3,426,879,145
2025	2028	251	761	1,726	39,662	42,400	38,098,152	98,589,336	190,319,061	3,262,437,964	3,589,444,513
2026	2029	176	629	1,516	40,503	42,824	28,813,450	85,087,382	173,172,799	3,475,706,069	3,762,779,700
2027	2030	121	513	1,324	41,294	43,252	20,882,176	72,578,868	157,741,958	3,693,564,973	3,944,767,975
2028	2031	82	413	1,147	42,043	43,685	14,715,638	61,276,477	142,887,499	3,918,714,657	4,137,594,271

**State of Alaska Teachers' Retirement System
 Projections Based on July 1, 2003 Valuation
 Population Growth 1 Percent**

Valuation Year	Fiscal Year	Annual Payment To Past Service Cost (000's)*				Present Value of Past Service Cost Payments (000's)**				Valuation Year	Fiscal Year
		Tier 1	Tier 2	Tier 3	Total	Tier 1	Tier 2	Tier 3	Total		
					6,641,180	234,981	556,468	1,292,193	2,083,642		
2003	2006	-	-	-	-	-	-	-	-	2003	2006
2004	2007	6,980	9,593	-	16,573	6,197	8,518	-	14,715	2004	2007
2005	2008	17,788	24,905	3,006	45,699	14,590	20,427	2,465	37,482	2005	2008
2006	2009	25,439	39,182	10,938	75,559	19,275	29,688	8,288	57,251	2006	2009
2007	2010	32,308	52,810	22,625	107,743	22,614	36,965	15,837	75,416	2007	2010
2008	2011	37,667	65,879	38,629	142,175	24,356	42,598	24,978	91,932	2008	2011
2009	2012	41,798	78,123	59,033	178,954	24,967	46,666	35,263	106,896	2009	2012
2010	2013	44,603	90,110	84,663	219,376	24,612	49,724	46,718	121,054	2010	2013
2011	2014	41,368	91,262	104,203	236,833	21,088	46,521	53,118	120,727	2011	2014
2012	2015	36,134	89,494	122,882	248,510	17,016	42,143	57,866	117,025	2012	2015
2013	2016	32,120	86,133	142,453	260,706	13,973	37,469	61,970	113,412	2013	2016
2014	2017	28,198	82,184	163,044	273,426	11,332	33,027	65,521	109,880	2014	2017
2015	2018	24,584	78,105	184,063	286,752	9,126	28,995	68,331	106,452	2015	2018
2016	2019	21,092	73,696	205,866	300,654	7,233	25,274	70,601	103,108	2016	2019
2017	2020	17,728	68,979	228,378	315,085	5,616	21,853	72,352	99,821	2017	2020
2018	2021	14,436	64,019	251,717	330,172	4,225	18,736	73,668	96,629	2018	2021
2019	2022	11,255	58,561	276,071	345,887	3,043	15,832	74,638	93,513	2019	2022
2020	2023	8,295	52,544	301,457	362,296	2,072	13,123	75,290	90,485	2020	2023
2021	2024	5,958	45,885	327,731	379,574	1,375	10,587	75,614	87,576	2021	2024
2022	2025	4,243	40,041	353,458	397,742	904	8,534	75,335	84,773	2022	2025
2023	2026	3,018	34,630	379,047	416,695	594	6,818	74,631	82,043	2023	2026
2024	2027	2,077	28,560	405,767	436,404	378	5,195	73,803	79,376	2024	2027
2025	2028	1,412	21,972	431,092	454,476	237	3,692	72,434	76,363	2025	2028
2026	2029	634	13,123	312,993	326,750	98	2,037	48,582	50,717	2026	2029
2027	2030	297	9,099	264,947	274,343	43	1,305	37,991	39,339	2027	2030
2028	2031	129	5,595	203,072	208,796	17	741	26,859	27,657	2028	2031
Total		459,561	1,304,484	4,877,135	6,641,180	234,981	556,468	1,292,193	2,083,642		

* Expected employer contributions paid during fiscal year

** Expected employer contributions during fiscal year, discounted to June 30, 2003 at 8.25%

State of Alaska Teachers' Retirement System
 Projections Based on July 1, 2003 Valuation
 Population Growth 1 Percent

Valuation Year	Fiscal Year	Number of Active Members				Projected Salaries				Valuation Year	Fiscal Year
		Tier 1	Tier 2	Tier 3	Total	Tier 1	Tier 2	Tier 3	Total		
2003	2006	3,533	6,342	-	9,875	224,321,356	308,308,644	-	532,630,000	2003	2006
2004	2007	3,250	5,878	846	9,974	234,219,606	321,912,859	-	556,132,465	2004	2007
2005	2008	2,778	5,474	1,821	10,073	223,184,546	312,480,238	37,711,792	573,376,576	2005	2008
2006	2009	2,461	5,113	2,600	10,174	197,505,616	304,204,838	84,924,658	586,635,112	2006	2009
2007	2010	2,165	4,794	3,317	10,276	181,302,565	296,350,944	126,966,178	604,619,687	2007	2010
2008	2011	1,903	4,499	3,977	10,379	165,278,628	289,067,834	169,500,401	623,846,863	2008	2011
2009	2012	1,655	4,224	4,604	10,483	150,568,581	281,424,078	212,655,302	644,647,961	2009	2012
2010	2013	1,421	3,960	5,206	10,587	135,653,981	274,058,655	257,489,490	667,202,126	2010	2013
2011	2014	1,180	3,701	5,812	10,693	120,738,837	266,359,405	304,130,800	691,229,042	2011	2014
2012	2015	1,002	3,408	6,390	10,800	104,129,396	257,896,541	354,113,311	716,139,248	2012	2015
2013	2016	842	3,115	6,951	10,908	91,516,579	245,407,254	405,873,541	742,797,374	2013	2016
2014	2017	703	2,841	7,473	11,017	79,515,576	231,752,432	459,769,165	771,037,173	2014	2017
2015	2018	579	2,575	7,973	11,127	68,718,148	218,322,646	514,504,374	801,545,168	2015	2018
2016	2019	468	2,320	8,451	11,239	58,527,452	204,500,661	571,260,238	834,288,351	2016	2019
2017	2020	368	2,075	8,908	11,351	48,901,037	190,275,091	629,969,112	869,145,240	2017	2020
2018	2021	278	1,831	9,356	11,465	39,625,543	175,721,394	690,920,442	906,267,379	2018	2021
2019	2022	201	1,586	9,792	11,579	30,763,576	160,070,010	754,611,837	945,445,423	2019	2022
2020	2023	142	1,336	10,217	11,695	22,597,174	143,143,575	821,249,702	986,990,451	2020	2023
2021	2024	99	1,125	10,588	11,812	16,196,454	124,733,989	890,898,931	1,031,829,374	2021	2024
2022	2025	70	940	10,920	11,930	11,524,721	108,766,612	960,136,374	1,080,427,707	2022	2025
2023	2026	47	745	11,257	12,049	8,200,329	94,088,348	1,029,847,409	1,132,136,086	2023	2026
2024	2027	32	548	11,590	12,170	5,650,344	77,695,776	1,103,866,284	1,187,212,404	2024	2027
2025	2028	21	462	11,809	12,292	3,869,034	60,221,757	1,181,532,316	1,245,623,107	2025	2028
2026	2029	12	389	12,013	12,414	2,535,473	52,493,844	1,251,970,579	1,306,999,896	2026	2029
2027	2030	7	321	12,211	12,539	1,484,959	45,493,666	1,324,737,179	1,371,715,804	2027	2030
2028	2031	4	260	12,400	12,664	887,477	38,582,813	1,400,496,073	1,439,966,363	2028	2031

State of Alaska

Division of Retirement & Benefits

Normal Cost Rate and Actuarial Computed Rate from FY 1983 through FY 2006

<u>Valuation report date June 30</u>	<u>Fiscal year of rate</u>	<u>Normal Cost rate PERS</u>	<u>Actuarial Computed Rate PERS</u>	<u>Normal Cost rate TRS</u>	<u>Actuarial Computed Rate TRS</u>
1980	1983	11.46%	13.78%	11.95%	16.84%
1981	1984	12.03%	13.68%	13.51%	17.42%
1982	1985	11.36%	13.62%	13.64%	17.96%
1983	1986	11.82%	13.59%	13.13%	17.36%
1984	1987	12.31%	13.84%	13.91%	13.28%
1985	1988	11.13%	9.55%	11.62%	13.28%
1986	1989	10.20%	9.38%	9.36%	11.16%
1987	1990	9.23%	9.30%	9.14%	8.19%
1988	1991	10.37%	12.00%	11.86%	12.27%
1989	1992	12.00%	14.20%	13.26%	15.16%
1990	1993	12.83%	13.58%	14.07%	19.65%
1991	1994	10.18%	13.72%	9.05%	15.59%
1992	1995	10.90%	13.70%	8.57%	13.36%
1993	1996	11.29%	12.82%	9.06%	12.48%
1994	1997	10.36%	12.14%	9.70%	14.96%
1995	1998	10.61%	11.90%	10.10%	14.94%
1996	1999	9.85%	7.74%	8.97%	10.52%
1997	2000	9.89%	7.36%	9.21%	13.00%
1998	2001	8.67%	7.03%	8.99%	10.55%
1999	2002	8.07%	6.56%	8.88%	7.09%
2000	2003	10.07%	6.12%	9.40%	8.29%
2001	2004	9.53%	6.77%	10.36%	14.44%
2002	2005	13.31%	24.91%	14.76%	35.57%
2003	2006	13.24%	25.63%	14.28%	38.85%

Normal Cost Rate: present value of benefits, which are expected to be credited with respect to service during the year beginning on the valuation date.

Actuarial Computed Rate: after comparing plan assets and liabilities, an actuarial rate is computed that would fully fund the retirement systems over 25 years. There are two components: the normal cost rate and the past service rate necessary to pay any unfunded liability. Both rates account for differences between actual experience versus anticipated results, changes in actuarial assumptions and / or methods, changes in statutory provisions, and the difference between the rate actually adopted by the Boards for a particular year versus the computed rate.

TRS

Possible Medical Scenarios for member before Medicare eligible (currently age 60 – 65) according to HB 238 – 2% HRA contribution

TRS early hire, 30 years, retires at 60 mo. Pre-Medicare – 90% subsidy	Amount in dollars
Cost of medical	301,491
Amount of subsidy	200,739
Amount paid by HRA	213,838
Net out of pocket expense to retiree 60 mo. Pre-Medicare medical coverage	-113,086

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TRS late hire, 20 years, retires at 60 mo. Pre-Medicare – 60% subsidy	Amount in dollars
Cost of medical	145,022
Amount of subsidy	64,373
Amount paid by HRA	79,518
Net out of pocket expense to retiree 60 mo. Pre-Medicare medical coverage	1,131

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TRS late hire, 20 years, retires at 60 mo. Pre-Medicare with spouse – 60% subsidy	Amount in dollars
Cost of medical	290,044
Amount of subsidy	128,745
Amount paid by HRA	72,101
Net out of pocket expense to retiree 60 mo. Pre-Medicare medical coverage	89,198

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PERS

Possible Medical Scenarios for member before Medicare eligible (currently age 60 – 65) according to HB 238 – 2% HRA contribution

PERS "other" early hire, 30 years, retires at 60 mo. Pre-Medicare – 90% subsidy	Amount in dollars
Cost of medical	304,491
Amount of subsidy	200,739
Amount paid by HRA	160,578
Net out of pocket expense to retiree 60 mo. Pre-Medicare medical coverage	-56,826

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PERS "other" late hire, 20 years, retires at 60 mo. Pre-Medicare with spouse – 60% subsidy	Amount in dollars
Cost of medical	290,044
Amount of subsidy	128,745
Amount paid by HRA	54,563
Net out of pocket expense to retiree 60 mo. Pre-Medicare medical coverage	106,736

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PERS "other" late hire, 20 years, retires at 60 mo. Pre-Medicare – 60% subsidy	Amount in dollars
Cost of medical	145,022
Amount of subsidy	64,373
Amount paid by HRA	59,536
Net out of pocket expense to retiree 60 mo. Pre-Medicare medical coverage	21,113

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MEMORANDUM

State of Alaska

Department of Law

TO: Ray Matiashowksi, Commissioner
Department of Administration

DATE: April 20, 2005

OUR FILE: 663-05-0192

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

TELEPHONE NO: 465-3600

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

SUBJECT: Retirement system
amendments -
constitutional issues

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

1. Is it allowable to increase PERS and TRS contribution rates for individuals who became members of the systems before the effective date of the rate increases?
2. Is it allowable to discontinue pre-funding the medical component or set a rate that targets less than 100 percent funding for existing members or new members?
3. Is it allowable to prospectively not pay existing members new [or additional] ad hoc post retirement pension adjustments (PRPAs)? If not, could a new statutory provision reduce the existing number of members eligible for this benefit prospectively to reduce costs to the system?

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

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

2. Pre-funding of the medical component of PERS and TRS benefits, to the extent that pre-funding would be considered an accrued benefit, may not be discontinued for members who were employed during the period that statutes required pre-funding. Funding of medical benefits may be set at less than 100% funding for new members.
3. If the financial condition of the funds does not permit payment of the PRPA, it is allowable to prospectively not pay existing members new [or additional] ad hoc PRPAs. A new statutory provision cannot reduce the existing number of members who retain a vested right to a PRPA if one is awarded, unless the new statutory provision includes comparable enhancements to benefits.

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

ALASKA CASE LAW

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

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

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

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

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

January 1, 1976.¹ Following passage of the referendum by a substantial majority of the voters in an election on August 24, 1976 (effective October 14, 1976), the state filed an action for declaratory judgment, arguing that article XII, section 7 did not apply and that the repeal was effective as to “officials who were participating in EPORS at the time of its repeal, but who were not then entitled to benefits.” 625 P. 2d at 845.

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

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

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

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

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

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

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

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

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

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

Id. at 1057.

Recognizing that "rigid adherence to labels like 'gratuity,' 'compensation,' 'contract,' and vested rights' has not allowed the courts the flexibility necessary to deal properly with legitimate legislative response to changing economic and social conditions," the court found California's "'limited vesting' approach to be instructive." *Id.* The court agreed with the California court's analysis⁴ and held

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

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

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

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

Id.

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

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

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

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

Id. at 1059.

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

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

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

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

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

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

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

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

Id. at 1089 n.13. The court explained

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

Id. at 1089.

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

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

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

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

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

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

we made it clear that the benefits in force at the time of enrollment in the system will be protected, stating:

[A member] is entitled to have the level of rights and benefits then in force *preserved in substance in his favor without any modification downwards.* ... When we speak of the level of rights and benefits protected by [this statute] we mean the *practical effect of the whole complex of provisions....*

Id. at 1087 (quoting *Opinion of the Justices*, 364 Mass. 847, 303 N.E.2d 320, 327 (1973) (emphasis added)).

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

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

Id. at 444. The court declined to adopt the reasoning of case law from other jurisdictions that upheld allocations of fund earnings or surpluses to supplemental benefits because those allocations did not diminish or impair payment of full benefits⁶ or to an underfunded plan because the system remained actuarially sound.⁷ Instead, the court was persuaded by *Valdes v. Cory*, 139 Cal. App.3d 773, 189 Cal. Rptr. 212 (1983). In *Valdes*, the Court of Appeal for the Third District of California held that provisions of emergency

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

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

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

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

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

944 P.2d at 445.

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

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

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

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

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

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

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

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

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

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

Id. at 891. The court cautioned that

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

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

RESPONSE TO QUESTIONS

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

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

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

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

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

substantially decreases plaintiffs' pension rights without offering any commensurate advantages, and there is no evidence or claim that the changes enacted bear any material relation to the integrity or successful operation of the pension system established by section 187 of the charter.

The provision raising the rate of an employee's contribution to the city pension fund from 2 percent of his salary to 10 percent obviously constitutes a substantial increase in the cost of pension protection to the employee without any corresponding increase in the amount of the benefit payments he will be entitled to receive upon his retirement.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

¹⁴ File no. 883-86-0140.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

acknowledged that “[b]ecause the right to receive a specific type of retirement benefit, including the PRPA, vests upon the date of employment, the ad hoc PRPA remains viable for members of PERS hired before the effective date of ch. 82, SLA 1986.” *Id.* at 1.¹⁷

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

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

Id. at 2.¹⁸

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

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

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

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

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

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

On the other hand, a substantial impairment may be constitutional if it is “reasonable and necessary to serve an important public purpose.” . . .

Both the California and United States Supreme Courts have identified factors which may warrant legislative impairment of vested contract rights on the grounds of necessity: “(1) the enactment serves to protect basic interests of society, (2) there is an emergency justification for the enactment, (3) the enactment is appropriate for the emergency and (4) the enactment is designed as a temporary measure, during which the vested contract rights are not lost but merely deferred for a brief period, interest running during the temporary deferment.”

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

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

Hon. Ray Matiashowski, Commissioner
Department of Administration
Re: Retirement system amendments – constitutional issues

April 20, 2005
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If the Alaska Supreme Court adopted these standards for approving impairments based on reasonableness and necessity, it would consider the facts specific to the legislative enactment. We are not in a position to express an opinion as to the adequacy under these standards of the reasons advanced by legislators in support of amendments to the retirement systems currently under consideration. We must emphasize the importance of establishing as complete a record as possible for any justifications supporting the change if we are to conduct an effective defense.

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

VBR:rca

Defined Benefits Plans vs. Defined Contribution Plans

Get the true facts

Defined Contribution plans don't cost less, THEY COST MORE.

The administration costs of defined contribution plans are higher than defined benefit plans. The average cost of administering a defined contribution plan is about 2% of assets; the average cost of administering a defined benefit plan is often times as low as 0.01% of total assets. This means 2% less money into your retirement system and more for large investment firms.

Call Alaska PERS at 465-4460 and ask what their administrative costs are. Call the Anchorage Police and Fire Retirement system at 343-8400 and ask what the administrative cost are. Call any defined benefits plan in the State of Alaska and compare those costs; you'll find they're much lower.

Defined Benefit plans outperform Defined Contribution plans in down markets.

According to Watson Wyatt Worldwide, a global consulting firm for corporations, defined benefit plans do better than defined contribution plans in down markets. Defined benefit plans have better diversified portfolios and are more professionally managed.

Don't take our word, call Watson Wyatt at 212-715-7000.

Defined Benefit plan outperform Defined ^{Contribution} ~~Benefit~~ plans in up markets.

A 2000 study found that over 20 years, public employees in a mandatory defined contribution plan posted an average return of 6-7% compared to 11% for the states with defined benefit plans.

Don't take our word, call the Nebraska's PERS at 402-471-7053 and confirm these facts and see why the State of Nebraska converted from a defined contribution plan to a defined benefit plan. That is why Nebraska's mission statement is: "The Nebraska Public Employees' Retirement System recognizes the importance of a successful retirement and is dedicated to providing the highest quality service necessary to assist members in achieving this goal." Shouldn't that be the State of Alaska's mission statement too?

Most large private companies use Defined Benefit plans.

Only 17% of Fortune 100 companies use a defined contribution plan as their primary benefit according to Watson Wyatt. Since 1985 there was an actual increase in the number of large employers that offered a defined benefit according to Employee Benefits Research Institute (EBRI). This occurred during periods of many large corporate mergers, where companies had a unique opportunity to select defined contribution plans.

Don't take our word, call Watson Wyatt at 212-715-7000. Call EBRI at 202-659-0670 and see where the trend in the private sector is really going.

We know you have difficult and complex problems to solve and are being told information that much of which is inconsistent and factually untrue. We urge you to stop...take some time and understand the impact of SB 141. The change you are about to make will affect our children's future, the next generation of our public workforce. It will also deeply impact our ability to recruit and retain the best public safety officers in the country.

This information is provided to you by the:

Anchorage Police Department Employees Association, the International Association of Firefighters, and the Public Safety Employees Association

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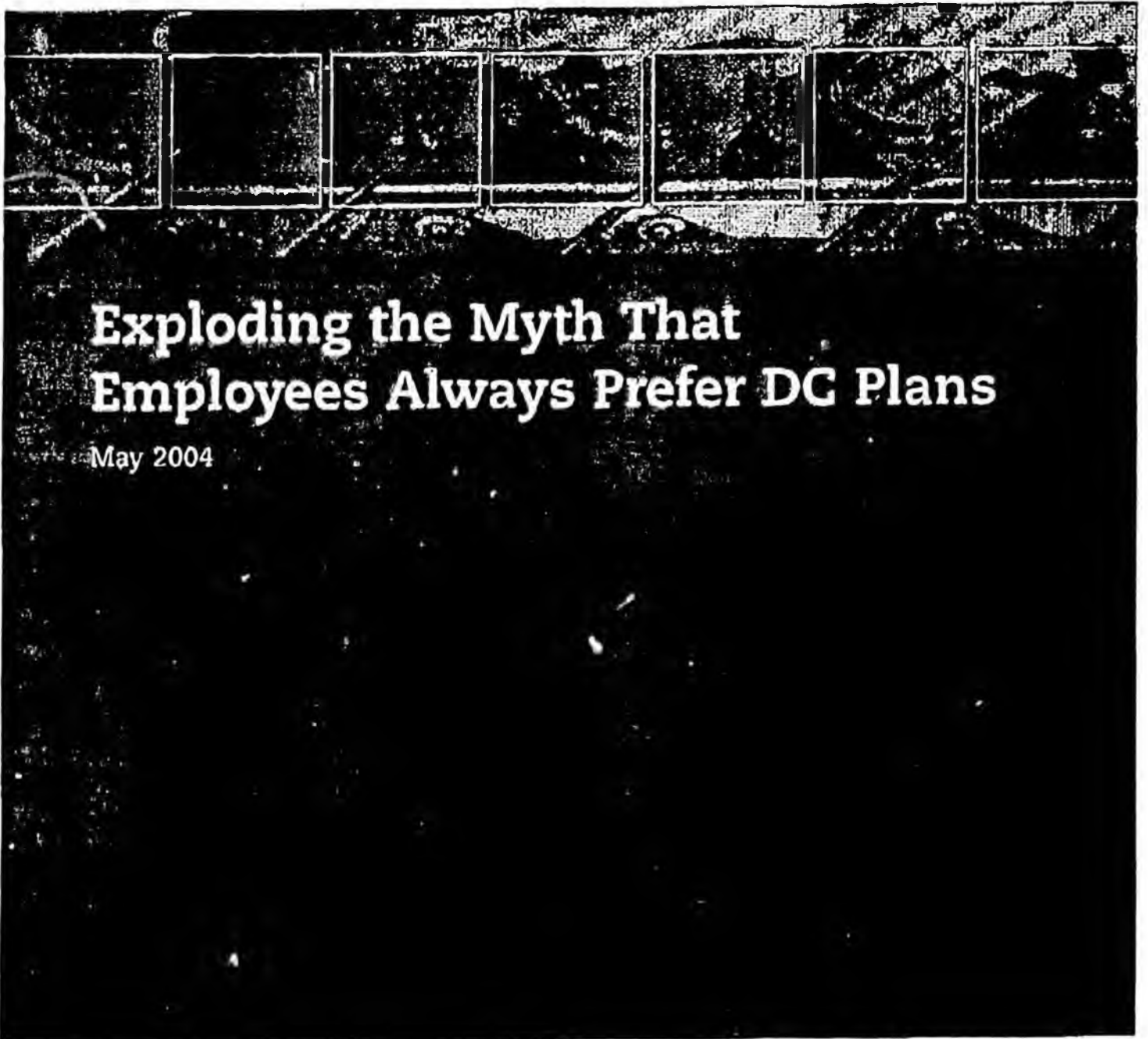
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MERCER
Human Resource Consulting

*A Mercer Perspective
on Retirement*



Exploding the Myth That Employees Always Prefer DC Plans

May 2004



New information about employee preferences

Many employers have decided to offer defined contribution (DC) retirement plans because they say their employees prefer them. But new evidence indicates that this stated preference is a myth. In fact, depending on the plan structure, employees at different ages and life-cycle stages may prefer defined benefit (DB) plans.

Surprising facts about employee preferences and employee understanding of retirement financing emerge from two recent studies: the Retirement Plan Preference Survey, a 2003 public opinion survey sponsored jointly by the Society of Actuaries and the American Academy of Actuaries, and the 2003 Process and Risks of Retirement Survey, sponsored by the Society of Actuaries.

Consequently, plan sponsors would be well advised to review the recent research that addresses worker preference, along with data about the elections employees actually make, before considering alternative programs.

Preferences about plan types

Myth	Employees prefer DC plans.
Fact	When given a choice between retirement plans, employees often choose to stay with the DB plan.

It is widely believed that employees generally prefer DC plans, particularly 401(k) plans, when given a choice of retirement plan types. Yet when traditional plans have been converted to DC plans and employees are given a choice between a DB or a DC plan, employees, including younger ones, often opt for the DB plan. Why? One possible explanation is that they tend to favor what they have. Another may be that upon learning the pros and cons of each plan, they prefer that the employer make the investment decisions and bear the risk.

The controversy over cash balance plans and the desire to enhance the perceived value of retirement programs has prompted employers to offer employees more retirement plan choices. Usually, it's between a traditional DB plan and either a new hybrid within the DB plan (usually a cash balance formula) or an enhanced DC plan. In our view, a substantial portion of the workforce frequently views traditional DB pro-

grams as competitive with or even superior to hybrid or DC plan designs - especially if employers clearly communicate the DB plan's benefits.

Consider the following examples.

- A large electronics employer offered its workers a choice between a traditional final average pay plan and a DC alternative (an enhanced match plus an annual contribution that was a fixed percentage of pay). To the employer's surprise, two-thirds of its employees, including a substantial portion of its younger employees, chose to remain under the traditional formula and forego the DC alternative.
- A large health care employer offers employees an annual option to forego additional benefit accruals in their DB plan in exchange for a substantially enhanced match on their 401(k) contributions that vest immediately. In the first year of the program, 80 percent of the employees either chose or defaulted into the traditional DB program, despite the enhanced 401(k) matching contributions.

Much of the perceived indifference that employees feel toward their DB pensions is caused by a communications gap - when this gap is closed, the indifference evaporates.



Is this research surprising?

Experience adds insights

Mercer has acquired insight and understanding in helping employers and other plan sponsors with their retirement benefit offerings. Some findings are consistent with or complement more recent analysis. We have long understood that:

- What people say and how they act are sometimes different. But by providing better communication, we can close this gap and bring people's intentions more in line with their actions.
- When private sector employees are given a choice, older employees and those with longer service want to stay with their traditional DB plans.

- Public sector employees, when given a choice of a DC or a traditional DB plan, often choose the DB plan.
- Rewards of expected high investment returns look great, but they are not guaranteed and may entail significant risk, which affects when employees can afford to retire.

Publicly available studies have consistently shown that workers misunderstand investment risk, investment options, and the impact of variability. Many employees erroneously think that money market mutual funds include stocks or that a diversified stock portfolio is riskier than company stock.

In summary

Traversing the future retirement landscape will be challenging because of the decline in the prevalence of DB plans, low savings rates in the United States, increasing retiree longevity, and the failure of many employees to plan for retirement effectively.

As research has shown, there is widespread ignorance, general confusion, and startling misperceptions about retirement planning. And any system that shifts too much of the financial burden onto employees is likely to leave some people without adequate resources.

Employers can adopt several different strategies to enhance their employees' retirement futures, including:

- Designing plans that use employer dollars most effectively and to add the most value, ensuring that plans enable employees to retire in accordance with company policy.
- Designing plans that make it easier for employees to save. For example, using a modest DB plan as a base and adding voluntary savings. Or including automatic enrollment, default investment options, and a mechanism to direct pay increases automatically into the DC plan to minimize decision making and maximize retirement savings.

- Augmenting education with fact-based research so employees can understand the implications of their choices.
- Maintaining a meaningful level of employer contributions to retirement programs, whether DB or DC.
- Managing plan administrative expenses.

DB or DC - a plan sponsor's choice

The best option depends on where within the life cycle most of your employees live and the specific plan designs. For younger employees who expect employment outside the firm, DC plans (or cash balance DB plans) are best because they're portable. For employees with long careers at one firm, traditional DB plans are usually better because they provide significantly greater benefits. Both types of plans can be designed to meet a specific cost level, but the DB plan is more likely to be the plan sponsor's plan of choice. For long service employees, long service employees will get much better benefits from the DB plan. So a plan sponsor should consider its objectives carefully when allocating available dollars among participants. Often, objectives are best met with a combination of plans.

Editorial Policy

The *Mercer Perspective on Retirement* series contains articles written by senior Mercer consultants that reflect their unique insights and observations on a variety of important topics affecting retirement and benefit programs. The views expressed do not necessarily reflect the views and policies of Mercer Human Resource Consulting, Inc.

Author

Anna M. Rappaport, FSA, is a principal with Mercer Human Resource Consulting. She is concerned about human resources strategy and financial security in an aging society, and about strategies to help businesses work most effectively in light of the changing demographics. She is a past president of the Society of Actuaries, serves on several boards, and is a frequent writer and speaker.

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Mayor Mark Begich

Department of Employee Relations

November 19, 2004

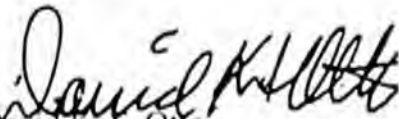
Public Employees' Retirement Board
PO Box 110203
Juneau, AK 99811-0203

Members of the Public Employees Retirement System Board:

The Municipality of Anchorage has followed the TIER IV development over the past year with much anticipation of and interest in the outcome. The Municipality is the second largest PERS employer, second only to the State of Alaska, and the decision made by the Board will potentially have significant impact on the Municipality of Anchorage and its future employees. As the TIER IV design concept approaches finalization, the Municipality of Anchorage would like to offer an opinion on the two options before the Board for consideration. The Municipality of Anchorage strongly urges the Board adopt the "Second Alternative" or Defined Contribution Alternative as the final TIER IV design. This design holds the least liability for employers going forward while still offering a competitive retirement product for our future employees.

The Municipality of Anchorage thanks the TIER Committee and the Board for its diligent efforts on behalf of the Municipality and its PERS employees.

Sincerely,


David K. F. Otto
Director, Employee Relations

Tier Design Alternatives

- Alternative 1 - DB/DC Hybrid Plan
- Alternative 2 - Pure DC Plan - eliminates Employer Risk

Community, Security, Prosperity

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REPRESENTATIVE Paul Seaton

District 35

Actual Projections of Pension Amounts

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TRS

HB 238 Projected Benefits – Rate of Return 8.25%

FEMALE			
Number of years worked	DC account lump sum at termination	Beginning annuity in 2004 dollars	% funded compared to current DB plan
10	\$9,167	\$5,356	81.2%
20	\$349,176	\$13,195	107.34%
30	\$948,959	\$24,864	138.93%

MALE			
Number of years worked	DC account lump sum at termination	Beginning annuity in 2004 dollars	% funded compared to current DB plan
10	\$98,267	\$5,806	88.02%
20	\$349,176	\$14,304	116.37%
30	\$948,959	\$26,954	150.61%

Assumptions:

Beginning Salary 37,538

Defined Contribution pension account percentage 15.25%

Anchorage CPI 3.73%

Real rate of interest 4.52%

Salary increase 3%

Based on 2000 mortality table (Mercer's projections are based on a 1994 mortality table)

TRS

HB 238 Projected Benefits – Rate of Return 6.25%

FEMALE			
Number of years worked	DC account lump sum at termination	Beginning annuity in 2004 dollars	% funded compared to current DB plan
10	\$88,937	\$3,999	60.62%
20	\$282,592	\$8,809	71.66%
30	\$678,771	\$14,671	81.97%

MALE			
Number of years worked	DC account lump sum at termination	Beginning annuity in 2004 dollars	% funded compared to current DB plan
10	\$88,937	\$4,428	67.12%
20	\$282,592	\$9,754	79.35%
30	\$678,771	\$16,245	90.77%

Assumptions:

Beginning Salary 37,538

Defined Contribution pension account percentage 15.25%

Anchorage CPI 3.73%

Real rate of interest 2.52%

Salary increase 3%

Based on 2000 mortality table (Mercer's projections are based on a 1994 mortality table)

PERS

HB 238 Projected Benefits – Rate of Return 8.25%

FEMALE			
Number of years worked	DC account lump sum at termination	Beginning annuity in 2004 dollars	% funded compared to current DB plan
10	\$79,650	\$4,341	77.2%
20	\$283,023	\$10,695	102.06%
30	\$769,174	\$20,153	132.09%

MALE			
Number of years worked	DC account lump sum at termination	Beginning annuity in 2004 dollars	% funded compared to current DB plan
10	\$79,650	\$4,706	83.69%
20	\$283,023	\$11,594	110.64%
30	\$769,174	\$21,848	143.2%

Assumptions:

Beginning Salary 32,000

Defined Contribution pension account percentage 14.5%

Anchorage CPI 3.73%

Real rate of interest 4.52%

Salary increase 3%

Based on 2000 mortality table (Mercer's projections are based on a 1994 mortality table)

PERS

HB 238 Projected Benefits – Rate of Return 6.25%

FEMALE			
Number of years worked	DC account lump sum at termination	Beginning annuity in 2004 dollars	% funded compared to current DC plan
10	\$72,087	\$3,241	57.64%
20	\$229,053	\$7,140	68.14%
30	\$550,174	\$11,892	77.94%

MALE			
Number of years worked	DC account lump sum at termination	Beginning annuity in 2004 dollars	% funded compared to current DB plan
10	\$72,087	\$3,589	63.82%
20	\$229,053	\$7,906	75.45%
30	\$550,174	\$13,167	86.3%

Assumptions:

Beginning Salary 32,000

Defined Contribution pension account percentage 14.5%

Anchorage CPI 3.73%

Real rate of interest 2.52%

Salary increase 3%

Based on 2000 mortality table (Mercer's projections are based on a 1994 mortality table)

PERS

SB 141 Projected Benefits – Rate of Return 8.25%

FEMALE			
Number of years worked	DC account lump sum at termination	Beginning annuity in 2004 dollars	% funded compared to current DB plan
10	\$68,664	\$3,742	66.5%
20	\$243,985	\$9,220	87.99%
30	\$663,081	\$17,374	113.87%

MALE			
Number of years worked	DC account lump sum at termination	Beginning annuity in 2004 dollars	% funded compared to current DB plan
10	\$68,664	\$4,057	72.15%
20	\$243,985	\$9,995	95.38%
30	\$663,081	\$18,834	123.45%

Assumptions:

Beginning Salary 32,000

Defined Contribution pension account percentage 12.5%

Anchorage CPI 3.73%

Real rate of interest 4.52%

Salary increase 3%

Based on 2000 mortality table (Mercer's projections are based on a 1994 mortality table)

TRS**SB 141 Projected Benefits – Rate of Return 6.25%**

FEMALE			
Number of years worked	DC account lump sum at termination	Beginning annuity in 2004 dollars	% funded compared to current DB plan
10	\$72,899	\$3,278	49.69%
20	\$231,632	\$7,221	58.74%
30	\$556,370	\$12,026	67.19%

MALE			
Number of years worked	DC account lump sum at termination	Beginning annuity in 2004 dollars	% funded compared to current DB plan
10	\$72,899	\$3,629	55.02%
20	\$231,632	\$7,995	65.04%
30	\$556,370	\$13,316	74.40%

Assumptions:

Beginning Salary 37,538

Defined Contribution pension account percentage 12.5%

Anchorage CPI 3.73%

Real rate of interest 2.52%

Salary increase 3%

Based on 2000 mortality table (Mercer's projections are based on a 1994 mortality table)

TRS
SB 141 Projected Benefits – Rate of Return 8.25%

FEMALE			
Number of years worked	DC account lump sum at termination	Beginning annuity in 2004 dollars	% funded compared to current DB plan
10	80,547	4,390	66.55%
20	286,210	10,816	87.99%
30	777,835	20,380	113.87%

MALE			
Number of years worked	DC account lump sum at termination	Beginning annuity in 2004 dollars	% funded compared to current DB plan
10	80,547	4,759	72.15%
20	286,210	11,725	95.38%
30	777,835	22,094	123.45%

Assumptions:

Beginning Salary 37,538

Defined Contribution pension account percentage 12.5%

Anchorage CPI 3.73%

Real rate of interest 4.52%

Salary increase 3%

Based on 2000 mortality table (Mercer's projections are based on a 1994 mortality table)

PERS

SB 141 Projected Benefits – Rate of Return 6.25%

FEMALE			
Number of years worked	DC account lump sum at termination	Beginning annuity in 2004 dollars	% funded compared to current DB plan
10	\$62,144	\$2,794	49.6%
20	\$197,460	\$6,155	58.74%
30	\$474,288	\$10,251	67.19%

MALE			
Number of years worked	DC account lump sum at termination	Beginning annuity in 2004 dollars	% funded compared to current DB plan
10	\$62,144	\$3,094	55.02%
20	\$197,460	\$6,816	65.04%
30	\$474,288	\$11,351	74.4%

Assumptions:

Beginning Salary 32,000

Defined Contribution pension account percentage 12.5%

Anchorage CPI 3.73%

Real rate of interest 2.52%

Salary increase 3%

Based on 2000 mortality table (Mercer's projections are based on a 1994 mortality table)



NEA-ALASKA

Affiliated with the National Education Association

TESTIMONY ON SB 141

HOUSE FINANCE

APRIL 23, 2005

TOM HARVEY, EXECUTIVE DIRECTOR, NEA-ALASKA

Good afternoon, Co-Chair Chenault, Co-Chair Meyer and members of the House Finance Committee. My name is Tom Harvey and I serve as the Executive Director for the 12,500 public school employees of NEA-Alaska.

I appreciate this opportunity to speak with the committee about Senate Bill 141. The House State Affairs Committee greatly improved SB 141 during the thirty-six hours it was in committee. NEA-Alaska recommends those improvements to you. As you might suspect our members cannot support this legislation in its present form. The main reason for our lack of support is SB 141 does not provide for a retirement with dignity for public school employees. There are several reasons why SB 141 does not meet retirement needs.

DC PLAN TO REPLACE DB PLAN:

One only needs to hear the testimony of the independent actuary, Joe Esuchanko, hired by the Legislative Council, to understand why a Defined Contributions (DC) plan is not Retirement Security for public school employees. Quoting him, "in general the defined contributions are not a reliable vehicle for a secure retirement..." The reasons he gave are the same provided by NEA-Alaska last May. When asked about a combination plan, his response was "that would be a very good plan."

The TRS/PERS committee voted unanimously to **OPPOSE** a strict DC plan. Dr. Richard Solie, an appointee of Governor Murkowski's to the TRS Board, testified that the Tier Committee "voted unanimously to support the hybrid plan." Even the present employers are against a complete shifting of risk to the employee. *NEA-Alaska recommends that House Finance adopt the ARM Board as proposed by House State Affairs and charge the ARM Board to examine the "blended plan" fashioned by the joint committee of PERS/TRS.*

It is worth noting that Mercer is using a methodology that only 11-16% of public systems utilize to determine liability of the systems. Of further note is the fact that the method being used leads to higher liability costs.

It has been NEA-Alaska's request since last May that the assumptions being used match the experience in Alaska.

Mercer's Assumptions

Inflation will be 3.5%
Wage Growth 3.75-4.5%
Investment return 8.25%
Health Care Costs 12.5% - 5%

Alaska's Experience

2.6% over any ten year period, *** uses 3% and Gov. uses 3%
1.36%
9% over any ten-year period
8% (7.5% according to Esuchanko)

Assumptions attached to Alaska's reality could definitely lead to a different liability amount.

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Harvey testimony
House Finance (4/23/05)
Page 2

There are many valid reasons why a DC program is not the option of choice for large employers, especially public employers. You have received a handout from your staff illustrating that only one state (Michigan) continues with a DC plan. Recently, Governor Schwarzenegger dropped plans in California to implement a DC plan. He suggested more time is needed to understand the complexities. Nebraska and West Virginia have recently decided against their Defined Contribution plans. A common theme is emerging; a DC plan does not allow a public employee to retire with dignity.

Alaska is NOT a Social Security state for public school employees. That means even if they earned Social security benefits in other jobs, they lose two-thirds of those benefits under federal law. Last year this legislature unanimously passed a resolution urging repeal of the law. Until that happens public school employees lack the safety net of retirement benefits that is available to private sector employees and to public sector employees in most other states. Two other non-Social Security states, Texas and California, have explored DC plans and backed-off.

One of the major reasons that the Defined Contributions (DC) is being considered is its predictability. The State will know what its liabilities are and can fund them. A major reason why the Defined Benefits Plan is not as predictable is the political whim of the legislator. When interested parties came to you for a benefit increase, you made the change because the actuary told you it would not add liability. Today we know better. NEA-Alaska recommends that you fix this loophole with an amendment regarding fiscal notes (SEE ATTACHMENT).

COMPOSITION OF A NEW BOARD:

We do not believe the current boards have erred. In fact we believe the three Boards have done an excellent job of advising the administration and Commissioners. ASPIB has invested better than the professional Permanent Fund trustees. TRS has advised against reducing the contribution rate contrary to the recommendation of the actuary. PERS has handled a large volume of hearings without much conflict or reversal.

NEA-Alaska understands the rationale of assuring that the revenue (ASPIB) and expense sides (TRS/PERS) of the equation are dealt with simultaneously. All parties get to question the actuary and receive the answers in a consistent manner.

NEA-Alaska strongly supports the amendments made by the House State Affairs Committee and urges House Finance to concur with those amendments. The changes by House State Affairs provide a good balance of gubernatorial appoints and elected representatives of the participants in the retirement systems.

POWERS AND DUTIES OF ARM BOARD:

NEA-Alaska believes that the adjudication of appeals related to decisions of the retirement system should be retained by the ARM Board. The Board could establish a subcommittee for PERS appeals and a subcommittee for TRS appeals. Each subcommittee should have five members. The main purpose of our proposal is to ensure that the appellant is heard by peers. Quoting Dr. Richard Solie, "because the boards act as a jury of peers in essence, I believe the board approach reduces the risk of further litigation and gives the beneficiaries a greater sense that their cases has been truly heard." Just look at the record of the present Boards to find the supporting evidence.

EMPLOYER/EMPLOYEE CONTRIBUTION TO THE DEFINED BENEFITS PLANS:

House State Affairs amended SB 141 to maintain the employee contribution at the present statutory levels. For TRS members that is 8.65%. NEA-Alaska applauds that amendment for three reasons: 1) prevents unrealistic employee contribution rate; 2) avoids a drain on the educator work force; and 3) stays out of troubled legal waters. Details of each issue are printed below.

The establishment of a floor for the employer contribution rate by House State Affairs is a rather improvement to SB 141. In the recent past (1998 – 2002) the lowering of the employer rate led to fewer earnings from investments. There needs to be a stable flow into the system, which will lead to appropriate investment returns.

1) After the initial stopping of hearts all throughout Alaska at the idea of losing 5% of their salary (original SB 141, Page 7), Sen. Stedman made the promised changes to the language and SB 141 required only a ½ of 1% increase to meet the "normal cost share of benefits." This proposal sounds fairly benign at first blush. But, when put into a proper context it is not such an easy pill to swallow. In 2020 the actuarially calculated costs for TRS sets the contribution rate at 52%. Thus, the employee and the employer would each contribute 26% of salary and payroll respectively. Can you imagine paying 26% of your salary for retirement benefits you are already promised? *No. The House State Affairs amendment prevents this unrealistic contribution level.*

If the cost share component in the original SB 141 were implemented it is conceivable that a number of veteran educators, who have 20 years of service, would choose to leave public service and probably leave the State of Alaska in lieu of paying increased contributions. Not only does this mean a brain drain, it means a greater increase in the liability of the system with fewer high salaried employees contributing and a longer period of time for these participants to be receiving benefits. *The House State Affairs amendment avoids the brain drain and increased liability to the system.*

One last remark on increasing employees' contributions without increasing corresponding benefits...this is clearly charting a course to troubled legal waters per Alaska's constitution. Dr. Richard J. Solie, a Governor Murkowski appointee to the TRS Board, has testified that the PERS/TRS Tier Committee did not consider this approach because of the concern "about the response of the judiciary." *The House State Affairs amendment steers clear of this legal matter.*

DEFINED CONTRIBUTION PLAN ELEMENTS:

SB 141 requires the employee to contribute 8% of compensation for pension purposes while the employer would contribute 4.5%. That is a total of 12.5%. NEA-Alaska testified before House State Affairs on April 19th that is not enough for investment purposes to provide for a retirement with dignity. *This was verified by Joe Esuchanko in his presentation to Legislative Council.*

If a teacher starts their career in Sitka this fall, they will have a salary of \$35,571 (SEE ATTACHMENT #2A & B). After a thirty-year career (That is 3 more years than the present average), the teacher will have \$800,129 in their account. That assumes a return on investment of 8.3%, which is 2.3% higher than an individual averages presently and is more the rate of return by ASPIB. They will also have an HRA of \$131,772. Their access to major medical insurance will cost \$96,602 in the first year (given an 8% annual inflation of medical costs). At age 62 the public servant will have no medical coverage or be in debt by \$141,897. *This is not retirement with dignity.* What is retirement with dignity? 70-80% of a person's salary at retirement according to most national studies and affirmed by Joe Esuchanko in his report to Legislative Council. For an educator today that would be approximately \$39,000.

The immediate response from the crafters of SB 141 is the employee can contribute more up to the IRC limits. Since 1989 the Teacher Average Salary has increased by a small 1.36% per annum, while inflation in Alaska averaged about 2.6%. Public school employees have steadily lost ground since 1989. The reality is the employee does not earn sufficient salary to make the added contributions. *NEA-Alaska recommends an increase in the employer's contribution rate for pension to 8.25% and the employee's contribution rate to 11%. This would create a total employer's contribution rate of 14% and provide for a 19.25% for pension.*

You might respond that the assumptions NEA-Alaska has made are not appropriate. NEA-Alaska believes that the assumptions made by the actuary are not appropriate or based in reality of Alaska's experience over the past three decades. *Before a true plan can be developed, agreement on the assumptions should be reached so we can determine what a public servant's retirement will actually provide.*

You might also respond that a thirty-year career is too short. In fact SB 141 actually assumes a person directly out of college would have a forty-two (42) year career. How many teachers do you know that have taught past forty-two years? The answer is very few. The reason is stress. You have recognized that a peace officer or firefighter has served well after twenty-five years. Why would you expect an educator to serve over forty-two years or leave and get another job for twelve years to have medical coverage until age 65?

The medical Program in SB 141 called for a 1.75% contribution from the employer instead of the original 3.75%, which is what is minimally needed to sustain a meaningful major medical plan. What happens when the 1.75% cannot cover the major medical plan? Are the benefits reduced? Are the premiums increased? *NEA-Alaska commends the amendment by House State Affairs that raised the medical contribution to 3.75%.* It should be noted that Joe Esuchanko testified that a contribution rate of 5% would be required to maintain a major medical plan for retirees.