

ALASKA LEGISLATURE

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Defined Contribution Plan

A defined contribution retirement plan provides members with individual retirement accounts. Usually both members and employers make annual contributions. Many programs allow members to perform their own asset allocations to funds selected in advance by the program administrator.⁷

Advantages for Workers

Portability. The clearest advantage for workers of the defined contribution plan is portability. The funds would be paid directly into each individual worker's own account and immediately become the worker's direct property. When a worker leaves state employment for another job, he or she can then take this individual retirement account with them. This account would include all past employer and employee contribution plus full market investment returns. Consequently, the defined contribution plan provides for full portability.

The current defined benefit plan, by contrast, has no real portability. When a worker leaves, he or she can take with them only their own past contributions plus fixed interest. They must give up the employer contributions for all of their years of work, all investment returns on those contributions, and the full market investment returns on their own contribution in excess of the fixed interest they can withdraw. This lack of portability is highly damaging to shorter term and younger workers.⁸ The system is skewed to favor the longer-term workers.

The defined contribution plan solves these problems with full and immediate portability. Under this plan, 100% of workers would get retirement benefits for the years they worked for state or local government. And they would take those benefits with them wherever they go. This would be highly beneficial for younger and shorter-term employees, which probably constitutes the majority of people who work for state or local government.

Vesting. The defined contribution plan also eliminates any vesting requirement. The funds paid into the worker's account immediately become the property of the worker and remain fully available to pay future retirement benefits. This includes the employer as well as employee contributions and all investment returns on those contributions. Under the current defined benefit system, by contrast, the 5-year vesting requirement eliminates any real benefit for workers who stay less than 5 years.

The defined contribution plan is consequently highly beneficial for these shortest term workers. A vesting requirement in a defined benefit plan makes sense to eliminate small and relatively inconsequential benefit payments to numerous short-term employees, and the burden of keeping

⁷ The Federal Reserve Bank of St. Louis, "The Role of Self-Regulation and Voluntary Compliance Incentives in the Design of Pension System." William Poole, September 25, 2003. Federal Reserve Bank of St. Louis, Available On-Line http://www.stlouisfed.com/news/speeches/2003/9_25_03.html.

⁸ Philadelphia Business Journal, In Depth: Human Resources, "Gen Y in search of flexibility." September 22, 2003. Available On-Line <http://philadelphia.bizjournal.com/philadelphia/stories/2003/09/22/focus1.html>

track of the financing and payment of such benefits. But in a defined contribution plan, the government simply pays a proportion of the worker's salary into the worker's own account and leaves it to the worker after that. Eliminating any vesting requirement here would allow all workers to receive retirement contributions for the years they worked for the government employer, without any significant administrative burden on the system.

Fair Benefits. Under traditional defined benefit plans, benefits are skewed to favor the longer term and oldest workers and disadvantage the younger and shorter-term workers. First, of course, the vesting requirements eliminate benefits for those working less than 5 years, with the funds devoted to benefits for those working longer term. Secondly, the benefits are a percentage of final salary, which tends to be much higher for those who have worked the longest, and for older workers. Thirdly, granting the same percentage of final salary for each year worked, does not give the full value to younger workers of the contributions made for them. The contributions paid into the system during years of employment, including the worker's own contributions, continue to earn investment returns for many years after the worker leaves government employment, but the worker will get nothing for all the years of investment returns on his contributions after he leaves employment. These returns will be redistributed to finance the higher benefits of older and longer-term workers.

Inflation makes the problem even worse. Salary increases over the years usually incorporate compensation for inflation. When benefits are calculated based on salary, they will incorporate the compensation for inflation included in the salary increases over the worker's career. But for younger, shorter-term workers, this inflation compensation stops when they leave government employment, as the salary used for their benefit calculations is fixed at that age. The value of the worker's benefits will consequently be depreciated by such inflation as well. By contrast, the longer term and older workers will be fully compensated for inflation through their salary increases over working years.

None of these distortions occur in the defined contribution plan. The contributions to the worker's account immediately vest as the property of the worker, so the worker gets to keep those contributions in any event. Each worker also gets the full market investment returns on the contributions for every year thereafter, giving him the full value of those contributions, rather than redistributing some to others based on a calculated percentage of final salary. Finally, those investment returns over the years will also include an inflation compensation component; again giving the worker compensation for inflation for each year after the contribution is made.

Consequently, the defined contribution plan gives fair, undistorted benefits to each and every worker. Those who work longer get proportionally higher benefits to the extent they worked longer. But they do not get disproportionately higher benefits, skewed to favor them over other workers, and effectively redistributing funds from these workers to them.

Personal Control. In the defined contribution plan, the retirement funds for each worker are under the direct ownership of the worker in his or her own individual account. Workers can pick the private investments that will best serve them in the private competitive market. They consequently no longer have to worry about adverse changes in their retirement plan or

politicians failing to make good on their promises, at least for the years already worked, as the contributions for those years already belong to them in full.

Better Benefits. Younger and shorter term workers who work roughly 20 years or less in government employment would generally get much better benefits from the defined contribution plan, because of all the factors discussed above. Even the long-term workers can achieve benefits from the defined contribution plan.

Take the example of a worker who earns \$30,000 per year over his career after inflation. Assume the same 6% of salary is paid into the defined contribution plan each year as paid currently into the defined benefit plan. After 40 years of work, this worker would retire with a fund of about \$250,000 in today's dollars. Assuming retirement at the normal Social Security retirement age, that fund would finance an annuity paying the worker almost \$35,000 per year each year for the rest of his life, or about 116% of preretirement income. The defined benefit plan would pay the worker 80% of final salary, or \$24,000 per year. So the defined contribution plan would actually pay the worker about 45% more.⁹

Advantage for Taxpayers

No Investment Risk. The most obvious advantage for taxpayers of the defined contribution plan is that it eliminates investment risk for them.¹⁰ With the government managing a common pool of investment funds under a defined benefit plan the taxpayers bear the complete risk of poor investment performance. If poor performance leaves the pool unable to pay the promised defined benefits, then the taxpayers will have to make up the difference.

Under the defined contribution plan, however, the taxpayers simply make a specific contribution to the accounts of the workers each month. The government then is not liable for investment performance.

No Political Risk. Defined contribution plans greatly reduce another set of risks that are usually overlooked- political risks. With the government specifying benefits far in the future, as under a defined benefit plan there is always a strong danger of political giveaways by shortsighted politicians. These politicians can promise higher retirement benefits, while leaving future officials and taxpayers to pay for them. Under a defined contribution plan, where the government does not specify future benefits but only makes regular investment contributions, this risk is eliminated.

⁹ Americans for Tax Reform: Policy Briefs: "Pension Liberation for Arizona." Peter J. Ferrara. Available On-Line: http://www.ATR.org/policybriefs/010799pb_az.html

¹⁰ Cascade Policy Institute, "Pension liberation for Oregon. A proposal to reform PERS." Peter J. Ferrara, J.D., May 2001. (See pages 11-17). Available On-Line: http://www.cascadepolicy.org/pdf/fiscal/1_117.pdf

Also see: American Legislative Exchange Council "Pension Liberation: A proactive Solution for the Nation's Public Pensions Systems." Peter J. Ferrara, August 1997. Available On-Line: <http://www.heartland.org/pdf/22664b.pdf>

Moreover, a large government investment pool, as under a defined benefit plan, is always subject to the danger of political interference that could raise costs. Political favoritism may influence investment policy, prohibiting some investments and forcing the fund into others. By taking the focus off of simply maximizing investment returns, such political favoritism will reduce investment returns and increase the cost of funding the specified defined benefits.

Politicians may seek to raid the large, tempting investment pool in other ways as well. They may seek to draw supposedly excess funds out of the pool in one way or another, perhaps by replacing an overfunded plan with a new one, or reducing the government's contributions. Or they may try to use the funds for short-term added benefits. Politicians and bureaucrats in other states have been known to siphon funds out of these plans improperly or illegally. These actions would again raise costs for taxpayers.

Government management of the funds also creates the risk of mishandling the funds by bureaucrats who lack the incentives, competitive pressures, and expertise of private investment managers. Attempts to insulate the funds from bureaucratic control by contracting out to private investment managers may not be entirely successful.

Even where there has been a good record of avoiding these abuses in the past, the danger is always present. However, none of these risks arising from a large government investment pool exist in a defined contribution plan, where the government does not maintain such a pool.

No Unfunded Liability. The defined contribution plan eliminates the danger of any unfunded liability, from any source, that must be covered by taxpayers. Under a defined benefit plan, the taxpayers, regardless of the cause of the shortfall, must cover any shortfall in the common investment pool that leaves the pool unable to pay the promised benefits, creating an unfunded liability. In the defined contribution plan, where the government does not maintain a common investment pool but only pays a specified amount to each worker's individual account each month, with these funds financing each worker's future benefits, there is no possibility of an unfunded liability that taxpayers would have to cover.

Greater Control Over Costs. The defined contribution plan provides the government and taxpayers greater control over costs. Costs under a defined benefit plan, where the government has pledged to provide a certain benefit amount regardless of cost, can vary greatly, depending on a wide range of factors outside the government's control. Retirees can live longer, greatly increasing costs. More workers may stay with the government employer long term, increasing costs. Interest rates or the stock market may decline, requiring increased contributions to make up the difference.

With the defined contribution plan, by contrast, the government is responsible only for a specified contribution each year. This contribution is completely dependent only on what the government agrees with workers or their union to pay. This means in turn greater certainty and predictability in budgeting. There is no possibility that taxpayers will be surprised with a large, unexpected unfunded liability that will require increased taxes or other funding measures.

Reduced Costs. A defined contribution plan will also significantly reduce costs. Defined benefit plans have large administrative costs for the government employer. The government must maintain and pay for the management of the large common pool of assets. It must also administer the benefits, determining eligibility and making payments.

With a defined contribution plan, by contrast, administrative costs for the government employer are negligible. The government simply pays an amount into each employee's own account as part of payroll processing. The worker takes over administration of the account after that.

What are the criticisms of a defined contribution plan?

Unsophisticated Workers

One of the major criticisms of defined contribution plans is that most workers are too unsophisticated about investing to handle the responsibility of directing their own retirement investments. This underestimates the capabilities of working people. The proposed plan is carefully structured to avoid this problem. Under the plan, workers would simply pick from a wide range of sophisticated, highly reliable investments.

Investment Risk

Probably the main criticism of defined contribution plans is that they shift investment risk from the employer to the worker. In a defined benefit plan, the worker receives the specified benefits regardless of investment performance, so the worker bears no investment risk. In a defined contribution plan, the worker's benefits depend entirely on the investment performance of his retirement account, so the worker bears full investment risk. Poor investment performance leads directly to lower benefits.

What is not widely recognized is that while defined contribution plans leave workers subject to investment risk, defined benefit plans without inflation adjustments leave workers subject to inflation risk. As inflation rises, the specified benefit in an unadjusted defined benefit plan is worth less and less. Under a defined contribution plan, by contrast, the worker's investments would rise along with inflation over the long run, providing a real, above inflation, market rate of return. This would tend to keep prospective long run benefits rising with inflation.

Also not sufficiently appreciated is that workers can fully handle the investment risk posed by defined contribution plans, for several reasons. First, retirement investments are very long term. The worker is investing not only for his entire career, but, indeed, for his entire life, as the remaining retirement fund will continue to be invested to support benefits throughout retirement. With such a long term investment horizon, perhaps 60 years or more, workers can weather many ups and downs in investment performance, with the average return on a diversified portfolio very likely over the long run to close in on the average long term market return.

Secondly, workers can easily invest in simple, widely available, highly diversified pools of stocks, bonds and other investments, through mutual funds and other vehicles. Such diversified pools will track the general market investment returns discussed above over the long run. Indeed,

with a sufficiently broad based investment pool, the worker would basically own a piece of the economy as a whole. If the entire economy collapses, state and local governments will not be able to support defined benefit plan promises either.

Thirdly, with professional investment managers handling the specific investments for workers, investment risk can be minimized in a sophisticated and reliable manner through diversification and other market strategies.

Workers, indeed, may be able to handle this investment risk better than state and local governments. For they can do so without all of the political risks discussed above.

Transition Issues

Another argument is that the transition to a defined contribution plan will be costly because the government will have to pay the workers leaving the defined benefit plan their share of accumulated funds to take to the new plan. But if the defined benefit plan is fully funded, then it will have the money to pay the departing workers saved in its common trust fund. If the defined benefit plan is not fully funded, as is the case with Alaska's defined benefit plan, then it needs to be in any event, and the government will have to bear that cost anyway.

Senate Bill 141

Alaska's retirement systems currently suffer from a \$5 Billion deficit, meaning that if all liabilities came due today we would not be able to pay for them. A combination of factors contributed to the problem: a three-year bear market, declining interest rates, failure to realize negative returns, legislation that increased benefits, artificially low contribution rates, understated system liabilities, and rising health care costs. Although this may be characterized as a "perfect storm" it is a perfect storm that may reoccur in the future. Many of these factors are beyond our control, which makes it difficult to predict and manage future costs. We cannot create a law that can fix the significantly underfunded status of the defined benefit plans. What we can do is implement management changes to the existing system and structural changes for new employees in order to move toward greater cost control and a fully funded retirement system. Movement to a defined contribution plan will remove the volatility that currently confronts employers. This will provide the employers with stable and predictable contribution costs going forward for new members.

SB 141 contains the tools to make those changes. The bill also has a fiscal patch. The fiscal note for the legislation includes a \$108 million deposit into the retirement trust for every participating employer. The \$108 million will address the 5% increase in PERS/TRS costs for FY 2006 and temporarily relieve the financial burden on political subdivisions and school districts.

Management changes to the existing system

The proposed bill streamlines the administration of the retirement systems by establishing the Alaska Retirement Management Board (ARMB) to replace the Alaska State Pension Investment Board (ASPIB), the Teacher's Retirement System (TRS) Board, and the Public Employees' Retirement System (PERS) Board. The new board will be more experienced with financial and pension matters than the current boards require, and will be charged with greater emphasis of its fiduciary role.

The ARMB will examine assets and liabilities in tandem in order to identify and address potential system problems in a timely fashion. Under the current structure the assets are housed in the Department of Revenue and invested by the ASPIB, while the liabilities are recorded in the Department of Administration. Accordingly, annual reports by each separate entity do not adequately put system assets and system liabilities side-by-side for a thorough analysis of the fiscal health of the entire system. SB 141 contains provisions that require greater coordination and communication between these two entities. The ARMB will have the capacity and the duty of compiling thorough system analyses, coordinating with the retirement system administrator to take into account all the system assets, liabilities and potential changes.

The ARMB will consist of nine trustees: the Commissioner of Revenue, the Commissioner of Administration, and seven appointed trustees with professional credentials or recognized competence in investment management, finance, banking, economics, accounting, pension administration or actuarial analysis. Of these seven appointed trustees, three will be members of the public, one will be a finance officer for a political subdivision in TRS, one will be a finance

officer for a political subdivision in PERS, one will be a member of PERS, and one will be a member of TRS.

The ARMB will have responsibility for setting the annual employer contribution rates and the annual interest rates credited to employee accounts for the existing PERS/TRS defined benefit plans. Tighter statutory language in this bill will prevent the Board from setting employer contribution rates below the actuarially computed normal cost rate and ensure that if the normal cost rate begins to climb, employees and employers will share in absorbing those costs. (The normal cost rate is the actuarially determined amount needed to pay for benefits expected to be earned by active members during the fiscal year.)

SB 141 also moves the responsibility for hearing benefit appeals to the Office of Administrative Hearings. By transferring this function to an administrative law judge, the bill offers assurance that appeal matters will be handled consistently, professionally and by unbiased adjudicators specially trained to handle the questions presented. Additionally, it will allow the Board to focus its attention and expertise in carrying out its fiscal responsibilities.

Structural changes for a new system that will eliminate volatility

The objective of SB 141 is to improve the long-term health and security of Alaska's retirement system. This bill starts with the research and conclusions in the Tier Redesign Initiative completed by the Alaska Division of Retirement and Benefits. This study is the result of the work of a taskforce formed at the request of the Commissioner of Administration in September of 2003 to study and evaluate new Tier proposals. The Tier Sub-Committee was comprised of two PERS Board members and two TRS Board members. Based on the findings of the task force, including support from employer groups, this legislation offers a new comprehensive retirement system based on a fundamental change from a defined benefit to a defined contribution plan. This will bring predictability to employer contributions and financial stability to the system while at the same time maintaining the attractiveness of public sector employment.

The bill establishes a defined contribution (DC) retirement plan for new employees that addresses the changing nature of today's workforce. National trends show that the overall workforce is aging while at the same time the likelihood of workers remaining with a single employer over their entire career is declining.¹¹ The DC plan presents the ability to accrue a meaningful benefit early in a career. In the DC plan, employees will have a retirement plan that is portable from job to job. Employees will have the ability to direct the investment of their retirement money. There will be contribution equity among employees and the contribution amount calculation is clear and easy to understand. This plan will provide the opportunity for non-career employees to realize greater retirement income and for all employees to obtain higher retirement benefits based on the financial experience of their account.¹²

¹¹ American Water Works Association (AWWA), E-MainStream, "Resources for recruiting employees." October 1999. Available On-Line: <http://www.awwa.org/communications/mainstream/archives/1999/October/msfocus1.cfm>

¹² Watson Wyatt-Insider, "The Changing Nature of Defined Benefits Plans" February 2005. Watson Wyatt-Insider, "Pensions in Crisis" September 2003. Available On-Line <http://www.watsonwyatt.com>

SB 141 also continues the tradition of offering insurability for all employees by providing access to major medical insurance. The bill addresses rising health care costs by both decreasing employer costs associated with providing medical coverage and providing an additional savings mechanism to assist retirees with their medical expenses. This mechanism is a Health Reimbursement Arrangement (HRA). An HRA is solely employer funded and reimburses retirees for qualified medical expenses up to a maximum dollar amount for a defined coverage period. The HRA is a new benefit, funded through the working lifetime of the employee, that provides the retiree the benefit of having money available for medical expenses that is nontaxable and interest bearing.

Defined Contribution (DC) Retirement Plan Elements

Individual Accounts

Each member will have an individual account into which both the employee and the employer will contribute a percentage of the employee's compensation, pre-tax. The rate of employee contribution to this account is a mandatory 8 percent with a mandatory employer contribution of 3.5 percent.

An employee may elect to contribute additional pre-tax earnings not to exceed the limits established by the Internal Revenue Code.

All members of the DC plan immediately vest in their own contributions and related earnings. Members gradually vest 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.

Employees can take their individual account with them when they leave employment and can "roll" in other qualified funds when they are hired. Employees will direct the investment of the funds in their individual account based on a range of investment options provided by the ARMB.

Medical Benefits

Employees will be eligible for major medical insurance and will have access to a Health Reimbursement Arrangement if the employee retires directly from the plan. An employee is eligible for retirement from the plan if: (1) the employee is at least 65 with 10 years of service; or (2) is a peace officer/firefighter with 25 years of service; or (3) has 30 years of service; and (4) has been an active member of the plan for at least a year prior to retirement.

Employees will have access to major medical insurance coverage. "Access" means that an eligible person may not be denied insurance coverage except for failure to pay the required premium. Retirees with 25 or 30 years of service, but who are less than Medicare age eligible (currently 65), must pay the full premium to receive coverage. There is one premium per retiree,

and different premiums will be calculated for single retirees versus retirees with a spouse and/or dependent children.

The defined contribution system contains shared health insurance premium payment provisions. The employer will contribute 3.75 percent of an employee's compensation to the group health insurance trust fund.

Once the retiree becomes Medicare eligible, the monthly medical premium is shared with the employer and coordinated with Medicare. The retiree's share depends on years of service:

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

The employer will contribute 1% of the average annual employer group compensation, to a maximum of \$500, to an HRA trust fund per member per year. The contribution is recorded in both an individual employee record of account and an employer record. Interest (the rate to be determined by the ARMB) on this account is posted to individual records annually. Contributions and interest accumulate over the working lifetime of employees.

The HRA Trust is an employer owned fund. Individual accounts of record are maintained for five years after an employee terminates without retiring. Terminated employee accounts revert to the employer unless the individual returns to work within the five-year period. A person who returns to work within the five-year period is attributed the account balance recorded in their name on the date of termination. Employers may use surplus funds held in the trust to credit individual employee records with the annual contributions owed by the employer.

Members who retire directly from the system (as well as their spouse and dependent children) are eligible for withdrawals from the HRA. The member's spouse and children remain eligible even if the retiree dies. Dependent children remain eligible even if the member and spouse die.

The HRA Trust can be used for reimbursements for qualified medical expenses under IRC 213(d), including medical premium payments. The total reimbursement is limited to the account balance recorded for the individual. There are no set limits for appropriate reimbursement other than exhaustion of the account balance.

Contributions by the employer are non-taxable when made and are non-taxable upon distribution. There are no IRS limits on reimbursement. Unused funds will rollover year-to-year, including annual interest.

Changes to the Defined Benefits Plans

SB 141 addresses contribution rates in the existing defined benefit plan by changing contribution calculations. The employee contribution rate is changed to the greater of: (1) the amount set in statute prior to enactment of this bill; or (2) one-half of the normal cost rate as determined by the ARMB. The employer contribution rate is changed so that it may not be less than the difference between the employee contribution and the normal cost rate that is set by the ARMB.

This bill also addresses the reinstatement of indebtedness provisions. It repeals the window for reinstatement effective June 30, 2010. This relieves the "off books" liability of hundreds of millions of dollars represented by more than 10,000 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 termination 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.

Finally, this bill addresses the cost of living adjustment (COLA) that is given only to retirees at least 65 years old, or persons receiving a disability benefit, who reside in Alaska. The 10% COLA is removed from the statutes.

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**PUBLIC EMPLOYEES' AND TEACHERS' RETIREMENT SYSTEMS
SUMMARY OF MAJOR BENEFIT CHANGES AND COST COMPARISON**

| | Current PERS Tier I/II & TRS Tier 1 DB Plan | Current PERS Tier II/III & TRS Tier II DB Plan | Senate Bill 141 DC Plan |
|--|--|---|---|
| PERS Employee Contribution Rate | 6.75% other 7.5% Police/Fire 9.6% school district | 6.75% or 7.5 Police/Fire 7.5% Police/Fire 9.6% school district | 8% all members voluntary % up to IRS limits |
| TRS Employee Contribution Rate | 8.65% | 8.65% | 8% all members |
| Vesting | 5 years PERS 8 year TRS | 5 years PERS 8 year TRS | Immediate for employee contributions Fully vested in employer contributions after 5 years. |
| Retirement Age | 55 normal - 50 early 30 years "all others" 20 Police/Fire 20 Teachers | 60 normal - 55 early 30 years "all others" 20 Police/Fire 20 Teachers | Any age |
| PERS and TRS Benefit Formula | 2% up to 2.5% multiplier per year DB multiplier x years of service x high 3 years avg salary | 2% up to 2.5% multiplier per year DB multiplier x years of service x high 3 (TRS) or 5 (PERS) years avg salary | 11.5% per year to DC account + investment earnings. HRA account accumulated over working lifetime |
| Medical | Do not have to retire directly from system to be service or age eligible for medical coverage. Medical plan premium paid by retirement system for all retirees and dependents. <i>Except</i> , Tier II retirees and survivors pay full premium under age 60. | Do not have to retire directly from system to be service or age eligible for medical coverage. Must have 10 years of service for system-paid coverage over age 60. Employees with less than 10 years pay full premium for access to coverage. | Must retire directly from system with minimum of 10 years of service for medical coverage and access to HRA. Access to medical coverage at age 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. Retiree and survivors pay full premium until Medicare eligible. After Medicare age eligible, retiree shares cost based on years of service. Reimbursed for qualified medical expenses from HRA. |
| Normal Cost Rate – PERS | 13.24% - Current Normal Cost Rate | 13.24% - Current Normal Cost Rate | 8.25% - reduces normal cost rate by 38% |
| <i>unfunded liability portion</i> | 12.39%- Past Service Rate | 12.39%- Past Service Rate | N/A |
| Normal Cost Rate – TRS | 14.28% - Current Normal Cost Rate | 14.28% - Current Normal Cost Rate | 8.25% - reduces normal cost rate by 42% |
| <i>unfunded liability portion</i> | 24.57% Past Service Rate | 24.57% Past Service Rate | N/A |
| Future exposure and volatility in investment earnings and increasing medical costs. | Employer bears all the risk. | Employer bears all the risk. | Employer risk is minimal: medical inflation with a capped percentage and shared with employee. Employee bears investment risk. |

Defined Contribution (DC) Plan Elements

- ◆ **Required Contributions**
 - Employee: 8.0% of compensation, deducted pre-tax by employer.
 - Employer: 3.5% of employee compensation.
 - Total individual account contributions: 11.5%.

- ◆ **Optional Contributions**
 - A member may elect to contribute additional earnings not to exceed the limits established by the Internal Revenue Code.

- ◆ **Vesting**
 - 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.

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

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

- ◆ **Distribution of Accounts**
 - Employee may elect a distribution of funds upon termination of employment, after 60 days.
 - Subject to IRC regulations.
 - May receive funds prior to 60 days for financial hardship.

Medical Program Elements

- ◆ **Required Contribution by Employer**
 - 3.75% of employee compensation.
 - Contribution is made to group health and life insurance trust fund to be used for employer share of retiree's monthly medical premiums.

◆ Retirement

- Retirement from the DC plan is required to obtain *access* to 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 pay the required premium.
- A member is eligible to retire if they have reached:
 - ⇒ normal retirement age of 65 and has minimum of 10 years of service; or
 - ⇒ has 25 years of service for peace officer/firefighter; or
 - ⇒ has 30 years of service for all others; and
 - ⇒ has been an active member for at least a year prior to retirement.

◆ Major Medical Insurance

- A member who meets the retirement provisions is eligible to enroll in the retiree major medical insurance plan.
 - ⇒ Insurance coverage includes the spouse and dependent children of the retiree.
- The surviving spouse of a retiree who was enrolled in the retiree major medical insurance plan is also eligible to enroll.
 - ⇒ Insurance coverage includes the dependent children of the surviving spouse.
- Retirees who meet the required years of service, but who are less than Medicare age eligible (presently age 65), must pay the full premium to receive coverage.
- 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%
- Only one premium per retiree and family.
- Different premiums developed for single retirees and retirees with spouse and/or children.

◆ Health Reimbursement Arrangement (HRA)

- **Required Contributions**
 - ⇒ Employer contributes an annual amount per employee to the health insurance trust fund.
 - ⇒ Calculation is 1% of average annual employer group compensation, to a maximum of \$500.
 - ⇒ Contribution is recorded in both an individual employee record of account and an employer record.
 - ⇒ Interest is posted to individual records annually, the rate determined by the ARMB.
 - ⇒ Contributions and interest accumulate over working lifetime of employees.

SB 141 Bullets

- **Employer Fund**
 - ⇒ The HRA Trust is an employer owned fund.
 - ⇒ Individual accounts of record are maintained for five years if an employee terminates without retiring.
 - ⇒ Terminated employee accounts revert to the employer unless the individual returns to work within the five-year period.
 - ⇒ A person who returns to work within the five-year period is attributed the account balance recorded in their name on the date of termination.
 - ⇒ Employers may use surplus funds held in the trust to credit individual employee records with the annual contributions owed by the employer.
- **Reimbursements**
 - ⇒ Who is eligible?
 - + Members who retire directly from the system plus their spouse and dependent children.
 - + Spouse and dependent children are still eligible if retiree dies.
 - + Dependent children are still eligible if both retiree and spouse die.
 - ⇒ Reimbursements made for qualified medical expenses under IRC 213(d), including medical premium payments.
 - ⇒ Total reimbursements are limited to an individual's recorded account.
 - ⇒ No set limits other than exhaustion of account balance.

Changes to Existing Retirement System

- ◆ **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)
 - ⇒ 9 trustees appointed by the Governor
 - + Commissioner of Administration
 - + Commissioner of Revenue
 - + 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)
 - ⇒ All trustees must have recognized competence in one or more fields of investment management, finance, banking, economics, accounting, pension administration, or actuarial analysis.
 - ⇒ Terms
 - + Staggered three years
 - + Limited to three consecutive terms with a required one-year break.

SB 141 Bullets

- ◆ **Authority and Responsibility of ARM Board**
 - Manage the assets of the defined benefits trust fund to meet pension liabilities.
 - Annual actuarial valuation of system plans, coordinating with the retirement system administrator.
 - Analysis of actuarial assumptions experience:
 - ⇒ Health costs assumptions annually.
 - ⇒ All other assumptions not less than every four years.
 - Audit of actuary not less than every four years.
 - Rate setting:
 - ⇒ 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.

- ◆ **Other Duties of the former PERS and TRS Boards Transferred**
 - To the Commissioner of Administration:
 - ⇒ Adoption of regulations governing the retirement systems.
 - ⇒ Requests for a waiver of any adjustment made to the retirement system accounts due to a change or error in contributions or benefit computations.
 - To the Office of Administrative Hearings:
 - ⇒ Adjudication of appeals related to decisions of the retirement system administrator.
 - ⇒ Adjudication of appeals related to the denial of a waiver for repayment of overpayments.

- ◆ **Employee and Employer Contributions to the Defined Benefits Plans**
 - The employee contribution rate is changed to the greater of:
 - ⇒ the amount set in statute prior to enactment of this bill; or
 - ⇒ one-half of the normal cost rate as determined by the ARM Board.
 - The employer contribution rate is changed so that it may not be less than the difference between the employee contribution and the normal cost rate that is set by the ARM Board.

- ◆ **Repeals**
 - Reinstatement of Indebtedness (refund) (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 10,000 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 termination by repaying the amount refunded plus interest.

SB 141 Bullets

- ⇒ In medical premiums alone, this amount stands at greater than \$107 million for one year in today's dollars.
- Cost of Living Adjustment (AS 14.25.142 and AS 39.35.480)
 - ⇒ This 10% adjustment is currently given to retirees at least 65 years old, or persons receiving a disability benefit, who reside in Alaska. (The repeal of AS 14.25.142 was inadvertently omitted from the bill.)
- ◆ Fiscal Note
 - Appropriates \$108 million directly to the retirement trust fund on behalf of all participating employers. This amount represents the 5% increase in PERS/TRS employer costs from FY2005 to FY2006.
- ◆ Intended Changes to SB 141
 - Establish a statutory requirement for an actuarial analysis prior to passage of any legislation affecting retirement benefits.
 - Define in statute the meaning of "the financial condition of the retirement fund" for the ad-hoc post retirement pension adjustment (applicable only to persons who were receiving a retirement or disability benefit prior to the 1986 amendments). (See editor's notes under AS 39.35.475)
 - Provide an option for unvested Tier III members of PERS and unvested Tier II members of TRS to convert to the defined contribution retirement plan if their employer allows it. The conversion would be matched dollar for dollar by the employer. However, the employer match would have to be new money to avoid eroding the funding status of the defined benefits plans.
 - Change the credited service requirement to 120 days for legislative employees under AS 39.35.385(f) from 60 days for persons first hired before May 30, 1987 and from 80 days for persons first hired after May 30, 1987.
 - Find a workable implementation date or a workable solution to the July 1, 2005 effective date. The timeline may be too short for a full system conversion.

Alaska Retirement System Boards

| Board | Alaska State Pension Investment Board (ASPIB) | Alaska Teachers' Retirement Board | Public Employees' Retirement Board | Alaska Retirement Management Board |
|-----------------------------|--|---|---|--|
| 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 | <u>All Appointed by the Governor</u> <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 |
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| Board | Alaska State Pension Investment Board (ASPIB) | Alaska Teachers' Retirement Board | Public Employees' Retirement Board | Alaska Retirement Management Board |
|---------------|--|--|--|---|
| 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 |

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LEGAL SERVICES

DIVISION OF LEGAL AND RESEARCH SERVICES
LEGISLATIVE AFFAIRS AGENCY
STATE OF ALASKA

(907) 465-3867 or 465-2450
FAX (907) 465-2029
Mail Stop 3101

State Capitol
Juneau, Alaska 99801-1182
Deliveries to: 129 6th St., Rm. 329

MEMORANDUM

April 2, 2005

SUBJECT: Need for a severability clause in CSSB 141(FIN)
(Work Order No. 24-LS0637AF)

TO: Senator Lyda Green
Attn: Traci Carpenter

FROM: Barbara R. Craver *BRC*
Legislative Counsel

You have asked whether a severability clause is needed in CSSB 141(FIN). In my opinion the answer is no. There is a general statutory severability provision at AS 01.10.030:

Severability. Any law heretofore or hereafter enacted by the Alaska legislature which lacks a severability clause shall be construed as though it contained the clause in the following language: "If any provision of this Act, or the application thereof to any person or circumstance is held invalid, the remainder of this Act and the application to other persons or circumstances shall not be affected thereby."

Adding a severability section to this bill would not add anything to the existing statutory presumption in fact a severability section would in turn cite to AS 01.10.030.

The courts will be looking at whether the unconstitutional sections can be separated from the constitutional sections without destroying the legislative purpose of the remaining sections. The ultimate factor determining whether an invalid provision of a bill is severable, or whether the entire bill fails due to the invalidity of single provision, is the intent of the legislature. If it is clear that the legislature intended a bill or a portion of a bill to take effect as passed by the legislature or not at all, then that bill or provision would be found to be nonseverable. *See, Lynden Transport, Inc. v. State*, 532 P.2d 700 (Alaska 1975). Having a severability clause will not make any difference to this analysis due the provisions of AS 01.10.030, however we can add one if you like.

If I may be of further assistance, please advise.

BRC:lmb
05-102.lmb

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If I may be of further assistance, please advise.

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05-102.lmb

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MEMORANDUM

April 4, 2005

SUBJECT: CSSB 141(FIN) version Y (Work Order No. 24-LS0637Y)

TO: Senator Lyda Green
Attn: Traci Carpenter

FROM: Barbara R. Craver *BRC*
Legislative Counsel

Enclosed is CSSB 141(FIN) version Y which incorporates the amendments provided on April 3, 2005. Please note the following changes I made or issues raised in this version of the bill.

14.25.143(a) - In regard to the issue of the ad-hoc post retirement pension adjustments (Ad Hoc PRPA) in SFIN amendment #11, although the amendment only provided an amendment in regard to the TRS Ad Hoc PRPA in effect between 1980 - 1988, the TRS Ad Hoc PRPA continued to exist up until 1990. I added an additional section to provide the same provisions to define "financial condition" as used in the amendment. Please see sections 5 and 6 in HB 238 (24-LS0761N), which Traci said was the model for this amendment.

14.25.550 - In SFIN amendment #8 you wanted AS 39.35.131 added to the new tiers, so although not listed, I added the TRS counterpart to that section (AS 14.25.040(d)) as AS 14.25.550.

14.25.560 and 14.25.570 - (Added by conceptual amendment SFIN #8). These two sections concern National Education Association and Special Education Service Agency employees. As Traci and I discussed, I omitted the references to retroactive indebtedness in these new sections that appear in the defined benefit plan counterparts (AS 14.25.045 and AS 14.25.047).

39.35.967 - (Added by conceptual amendment SFIN #8). This is a counterpart section for the new tier of PERS for the administrative director of courts, (AS 39.35.158 in earlier tiers.) I deleted references to "credited service". I remain concerned in regard to the concept of years of service which has applicability to the medical benefits in the defined contribution plan. In this case, the administrator would withdraw from the judicial retirement system, and in joining the PERS defined contribution plan, would start with zero years of membership service as far as medical benefits, although the member contribution account could be rolled into the defined contribution individual account.

If I may be of further assistance, please advise.

BRC:jad
05-181.jad

Enclosure

UNIVERSITY OF ALASKA
Statewide Office of Human Resources

Comment of Fiscal Impact of Proposed University Amendments to the Optional
Retirement Program

April 5, 2005

With passage of this bill, as amended at the request of the University, it is anticipated that avoided cost up to \$200,000 can be achieved in FY06.

In subsequent years, subject to consultation and decision by the University's Board of Regents to modify the plan with added discretion provided by the bill, it is anticipated the cost avoidance will reach \$1 million per year, for cumulative cost avoidance nearing \$10 million over the next several years.

Respectfully Submitted by:



Jim Johnson
Vice President for Faculty and Staff Relations

FAX TO : 907-465-3805

SB

141

(FILE 4)

SFIN

FILE

Testimony on SB 141 Before the Senate Finance Committee

by

Kerry Jarrell, CPA, Assistant Superintendent, Bering Strait School District,
& Teacher Retirement System Board Member

March 29, 2005

Rhetoric in the press has described the current condition of the retirement systems as the "PERS/TRS meltdown". The combined conditions have been characterized in the SB141 White Paper as a "perfect storm". It is important to understand that, contrary to the recent rhetoric, the factors that led us to this point were not immediate, not rapidly developing, and do not represent a meltdown. I am not suggesting that the issues are not real, but I am suggesting that they need to be viewed in their proper context.

Retirement systems are like supertankers that respond slowly to environmental conditions and corrective actions. The seeds of the problems as well as the successes of the plans were planted and nourished over the past twenty-five years. When critics speak of the funding "crises" or "meltdown" of today, they are actually looking twenty-five years into the future and projecting what cumulatively will occur over that period. Just as actuaries may have erred on many projections over the past quarter of a century, current actuarial estimates will no doubt miss the mark over the next quarter of a century. Minor changes in assumptions can cause enormous changes in the funding status of the plans. Consider that a 2% change up or down in the estimate of the rate of growth of health care would change the unfunded liability of the plans by over a billion dollars.

Actuaries will be the first to admit that their projections are far from an exact science. It is evident today that many of the assumptions throughout the 1990's were incorrect. Health care costs were growing much faster than we realized for nearly a decade before actuarial assumptions were revised around 2002. The retirement plans that appeared fully funded in the late 1990's were obviously under funded. Correcting those assumptions in 2002 resulted in a multi-year adjustment that startled everyone. Those adjustments did not reveal mismanagement of the assets by the ASPIB, the

testified 3/29/05

boards, or the administration. They simply revealed that the state, its municipalities, and its school districts had been underpaying the necessary contributions for health care to keep the system healthy. Had more accurate rates been imposed earlier, the unfunded liability would not sit on the books of the retirement systems, it would be reflected on the books of the municipalities, boroughs, and school districts.

I would like to offer the following observations and recommendations for the legislature to consider.

1. The major problem with our retirement plans is health care. In the 1980's and early 1990's health care was relatively more affordable than it is today. For the eleven-year period from 1992 to 2003, 69 % of the increase in unfunded liabilities, amounting to roughly \$3.7 billion, came from excess increases in health care costs. I use the term "excess" to mean that health care costs were \$3.7 billion more than the plan benchmark or estimate for that period. If it weren't for that \$3.7 billion deficit, we would not be here today and there would be no discussion of overhauling the retirement system.
2. The retirement super tanker has developed several leaks. By leaks, I mean benefits have been provided that have not been funded or calculated into the contribution rates. These leaks mandate payments greater than the plan ever intended. For example, there is no correlation between the earnings and contributions of part-time local public officials and the eventual benefits provided to those individuals. Under current provisions, a school board member or council member earns and pays little into the system, but they receive free medical coverage at 55 or 60. Their contribution to the retirement system could be as low as \$1,000 over their entire career, yet they could receive almost unlimited medical for them and their dependents for up to a generation.

Additionally, many schemes have been used by employees to boost eligible salaries in the final years of employment. Consequently, salary rates are often considerably higher than they should be. Termination bonuses have recently been identified in the press, but service credits, overtime, final year pay increases, etc. can produce large increases in benefits without reasonable

contributions to the system to offset them. These practices create unfunded liabilities.

One of the most overlooked leaks in the super tanker is masked in the benefit formula itself. Using the high three years for benefit calculation produces built in losses for the system. This piece of the formula, which has been considered sacred until now, consistently created an unfunded liability for every single participant.

3. Much has been spoken about reducing the risk to the employers by moving to defined contribution plans. While the change to a defined contribution plan may limit the exposure for local and state governments, any plan that undermines the retirement security of public employees will eventually drive good people from public service. Retirement plans, by their very nature, are structured to protect employees, not to take advantage of them. A blended approach that gradually introduces the concept will spread risk equally among employers, the state, and employees.

Recommendations:

1. Immediate changes need to be made to the health plan in order to maximize savings in every area possible. Aggressive steps should be taken to initiate preferred provider networks. Preferred prescription providers and the use of generic drugs should become mandatory under the plan. Increasing co-payments for drugs and services would spread the cost of services among beneficiaries and the plan. Disease management and large case management have been extremely beneficial in reducing unnecessary procedures and limiting hospital stays. I have personally administered a large self-funded plan for our school district for the past ten years. We have successfully implemented all of these procedures and realized considerable savings from them. The PERS/TRS Health Plan is large enough to wield considerable influence in negotiating savings with service providers.
2. Implement the changes in health care access that were recommended in the PERS & TRS Tier Proposals. These included limiting entry into the system until beneficiaries reach the age of 65 and assessing premiums

based on years of service. Limiting access to health care for part time elected officials would also help relieve the unfunded liability.

3. Stop the leaks caused by unfunded benefits. Any provision in the current statutes that drains from the system should be identified and corrected. Make the necessary changes to statutes that currently allow supplemental earnings to boost the wage base for retirement calculations.
4. Amend the formula for retirement benefits to create a more reasonable base period for eligible salaries. A minimum of ten years of earnings should be used for benefit calculation purposes. This will dilute the effects of any large payouts in the final years of employment and will help insure that benefits more evenly match contributions.
5. Take a very conservative approach in implementing elements of a defined contribution plan. The division of retirement and benefits has offered PERS and TRS Tier Proposals that incorporate a defined contribution plan that is more gradual. It provides significantly more protection for the state and the employer without totally abolishing the benefits of the current plan. The plans are healthy in terms of their ability to pay pension benefits. In spite of all of the bear market, low interest rates, legislative changes, etc., the pension portion of the plans were well funded and were in the top ten percent of state retirement systems as measured by one of the top pension experts, Wilshire Research. The success of that portion of the plans should be preserved to the extent possible.

The plans have served the state and its residents well for many years and can continue to do so in the future. Rather than dismantling the plan, we urge you to consider a combination of mid-course corrections and prospective changes.

We thank you for the opportunity to address these issues. I would be happy to answer any questions from the committee.

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Good afternoon. My name is Gayle Harbo and I have been a resident of Alaska since 1957, most of the time living in Fairbanks. I taught in Fairbanks for 25 years, most of the time at Lathrop High School and was Chair of the Math Dept and Advanced Placement Coordinator for almost 20 years. I am here as a member of the Teacher Retirement Board. The joint boards thank Senator Stedeman for his willingness to teleconference with us on Friday Mar. 25. We are sorry his plans changed but since he could not teleconference hope he and the Committee will read the verbatim transcript of the morning's discussion so they realize the depth of true concern that each Board member has regarding all the bills which seriously impact a retirement system which has worked well for 50 years. The only significant changes that have been made in recent years have been enhancements of benefits due to legislation. The Joint Boards have sent letters to the Legislature these past two years asking that you not introduce any bills which enhance benefits and the Administration has agreed to testify against these bills because all would increase the unfunded liability.

I am going to address 3 topics in my remarks and will be happy to answer any questions. If I don't know the answer I will try to find out.

My first issue is the interaction of the 3 Pension Boards. As you know the main work of the TRS and PERS Boards is listening to appeals of members, recommending employer contribution rates and adopting actuarial assumptions every 5 years based on the recommendations of the Commissioner of Administration and the actuary. ASPIB manages and invests the contributions to the system. The Joint Board members have great admiration and respect for the way ASPIB and the staff of Revenue, who work with Gary Bader, invest and care for our funds. Over the past 10 years the funds have earned almost 9% annually, at or near the assumed rate of our actuary. Earnings are not the problem causing the unfunded liability.

This leads to my second issue. The main driver of the decrease in the funding ratio has been the rapid increase in health care costs., a problem not unique to Alaska. You have seen in past presentations that without the inclusion of medical costs the funding ratio is a respectable 91% for TRS and 120% for PERS. Health care costs have accounted for 50% of the employer contribution rate increases in past few years. The Administration can make changes in the Health Care plan without legislation. First, changes can be made to the plan for current tiers if they do not diminish benefits, but are a matter of choice or convenience. (An example would be requiring members use hospitals, both in and out of Alaska, which are preferred providers so

significant savings could be negotiated - Providence in Anch. is not a PP yet over 80% of retirees go there, the hospitals in Juneau and Sitka are owned by their respective cities. They are not preferred providers and there is little savings to the state.) Secondly, significant changes can be made to the plan for employees hired after a specific date.

About 5 years ago the Joint Boards recommended an education program to encourage members to use Generic Drugs. The members responded and now 42% of the drugs used are generic. Every percent of brand name drugs replaced by generics saves the plan 1M. (see Oct. '04 Newsbreak). The Health Care Committee has for several years recommended the state pilot a disease mgt. program, particularly for diabetes, but we were told that the start up cost of \$240000 was too much. In speaking with other health plan administrators who utilize disease mgt. I have been told that the cost savings in the first four years are considerable and would more than recoup the start up costs. Mr. Mike Humphries, from the benefits division at the U of A, the NEA Health Trust and, perhaps Mr. Jarrell, our new trustee from Bering Straits School District, indicate their plans incorporate this element. For retirees this past year, 474 members had claims of over \$50000 each and accounted for 53M of the medical expenses to the state plan. Surely disease mgt could have reduced some of this cost. Other than the generic drug campaign no substantive cost savings measures have been taken. The Health Care Committee has presented a list of several cost savings measures that we, and the entire Jt Board, would like to see initiated. The Boards can only recommend, however, not implement. I feel we would not be at this juncture, with drastic changes recommended to the system, if this Administration and past Administrations had held a Forum with employers, legislators, representatives of unions and the Municipal League and medical professionals to discuss methods of resolving these skyrocketing costs. We all recognize the problem and would like to be part of the solution, not adversaries. Senator Seaton has a bill regarding generics and closed formularies. This does not have to be legislated - the Administration can make those changes now as long as they do not diminish benefits to the current tiers.

My third issue deals with the comments by some that the Boards have not been responsible in recommending the employer contribution rate and with the awarding of the ad hoc PRPA. Wrt TERS and the employer rate, it is a

recommendation, the Administration can set the rate higher. The Boards act with information provided them by the Administration and the actuary. In the early '90's the TRS Bd adopted a 12% employer rate and to ensure stability for employers for future planning, they intended this rate be used for at least 20 years. In 2000 and 2001, however, when setting the rates for FY'02 and FY'03, Mercer, our actuary, recommended rates as low as 7.09% and 8.29% for those fiscal years. The TRS Bds did, in those two years, drop the rate to 11%; had they not, the employers may have been upset. In '03 we set the rate at 16%, though the first motion was for 17%. The contribution rate has been higher - in FY' 83 and '84 the combined rate for state and school district was close to 18%. When I started teaching in the '60's, employee, employer and the state each contributed 7%. The employee population at the University that is not under TRS, but under private accounts, has a match by the employer of roughly two to one.

The other issue of Ad Hoc PRPA's apparently needs to be clarified since you were given a paper dated Mar. 18 from Mercer regarding the funding status due to plan changes, mostly enhancements through legislation, and Ad Hoc PRPAs. As you know the Boards recommend Ad Hocs on the basis of information provided by the actuary and the Commissioner of Administration. The Boards have only made recommendations when the funds were healthy. No Ad Hoc has been recommended since 2003. A retiree gets either the Ad Hoc or the automatic PRPA, not both. In the past years when the Ad Hoc has been awarded it only causes a small "blip" in the increase of the employer contribution rate, probably less than .06%. The Mar. 18 letter fails to indicate that probably 99% of the ad hoc cost mentioned, resulted from the settlement of a lawsuit in the mid '90's. The state lost the lawsuit and as a result had to make all retirees whole, from the time they retired, wrt the PRPA. The dollars paid out include not only past prpas but the interest earned. Many individual retirees who had been retired 30 to 40 years received checks close to \$10000. The lawsuit, as many of you may remember resulted because past administrations had not awarded a prpa when the fund was "healthy".

The Mar. 18 letter also attributes nearly 1B of the increase to the unfunded liability to benefit enhancements by the legislature. The Boards have said many times that "tinkering" with the tiers, once they have been established has not been in the best interest of the funds and for some of

these changes the actuary has not accurately predicted the rapid rise in health care costs. In the assumptions adopted by the Boards, the last time in Dec. of 2000, Mercer had a Medical assumption rate of 5.5%. We now know was not a realistic assumption. The Boards requested an Actuarial Audit in 2001 and the resulting report indicated that we should look at Medical assumptions on an annual basis. You also know that the RIP programs advocated by the Legislature in the early '90's were to be cost neutral, but this past year Mercer indicated they have had a negative affect on the funding ratio, primarily because of escalating Medical costs. Despite this poor advice, if you examine Mercer's budget line item over the past few years, you will see there has been a 100% increase in their fees.

I thank you again for your time and hope you will carefully consider whether drastic measures need to be taken at this time. We all agree there is a problem and we hope by working together we can begin to solve it, but please do not burden future hires for the mistakes of others. Changes can be made, without legislation, to control current and future costs. Please let us work together to make Alaska continue to be the place young people will want to come to work, as you and I once did.

Louise Harbo JRS
3/29/05

TESTIMONY by Gayle Harbo
TRS Trustee
House State Affairs and Senate Finance

I know the legislature is trying to find solutions to a perceived problem with a retirement system that has worked well for almost 50 years. I respect your concern. I am not a political person, but I am an Alaskan of almost 50 years, a mother, a grandmother, a retired teacher and most recently a member of the TRS Board. I urge you to go slowly, get a second opinion from a credible actuary and talk with affected parties about the reasons for the decrease in the funding ratio before you impose devastating changes.

What affects the funding ratio? If you read the last valuation you will see that TRS is almost 92% funded without health care costs: PERS is 120% funded. Are these healthy systems???? What would your conclusion be? Has ASPIB done a great job??? What would your conclusion be?

Now look at the ratios with Medical costs factored in - remember Alaska is one of only 4 states that pre-funds medical costs. In FY'06, under GASB, all states will have to acknowledge medical costs as a liability. With Medical the TRS ratio drops to about 63% and PERS ratio to 73%. What would your conclusion be? What is the major factor affecting the declining ratio?

Medical costs have been the main factor and if the Administration would make some allowable changes, matters of choice and convenience, they could save millions of dollars on the health plan for the current tiers. They can change the Health Benefits for new hires without legislation - prospective is the key word here. Ask them why they have not made significant changes in the last 4 or 5 years.

You may have received a memo from Mercer, dated March 18, which shows two items which have also contributed to the unfunded liability. One is the enhancement of benefits that various legislatures have passed in recent years; some which the actuary said would be cost neutral. Actuaries, like airlines, are cautious people and always have a disclaimer, "subject to change without notice". They told you Retirement Incentive Programs would not negatively affect the funding ratio. This past year they changed their story - they did not predict the impact of medical costs correctly. The Boards asked for an Actuarial Audit in 2002 -2003 - In our Sept.'04 Joint Board minutes the auditor, Milliman, stated (on page 6) that Mercer 's "starting point for projecting forward was a number that was 14 percent too low." The minutes also reflect that medical costs account for 50% of the increases in employer contribution rates these past years. The Joint Boards, these past two years, have asked the Legislature not to pass legislation which will enhance benefits for existing Tiers and you have held off.



Compliments of...

4/6/05

Gary Wilken

Senator, Fairbanks

The second item in the March 18th letter refers to the Ad Hoc PRPA which is recommended by the Boards only when the fund is healthy. The sheet attributes huge costs to the Ad Hoc PRPA, but fails to mention that dollars of that cost was the settlement of a lawsuit that made all living retirees whole, from their time of retirement, for ad hoc PRPA's that had not been awarded. Take that out and an ad hoc is a mere blip.

In the legislation proposing a DC plan teachers are more impacted than Public Employees. Teachers did not have the choice of an SBS plan when they were pulled from SS. Not only that, because they are public employees, even though they may earn SS credits, they will not get all that is due them because of two unfair Federal Provisions, GPO/WEF, which the Legislature last year recognized as unfair when they passed a resolution urging our Congressional Delegation to seek repeal.

I urge you to take time to get a second opinion. I urge you to work with the Boards and the Employers and the AML and successful Health Care Trusts and Plans to see how medical costs can be properly managed.

While I respect Dr. Solie's opinion, it is a lofty one. He may not realize that many of the people I worked with every day did not earn enough to save and invest the minimum needed to start a mutual fund. These people need the security and assurance in their senior years that a Defined Benefit offers. People need a system which recognizes inflation, as SS does, to adjust their annual retirement income.

Dr. Solie erred in his testimony on HB 238. He implied, using a 2000 mortality table and other assumptions used by Mercer, that a person retiring from the proposed DC plan would be better off than a Tier I employee. It is a devastating error to future retirees, that I, a humble, public school teacher must point out. If this legislature did what Dr. Solie suggested many retirees would run out of dollars long before they died.

It is a grave error to apply group assumptions of a DB plan to individual assumptions on which DC plans are based. You would do grievous harm to thousands of seniors if you relied on Dr. Solie's data. Please go slowly and check and recheck and ask for all the information ... not selected sound bits.

Please work with the Boards these next years to solve the Medical cost problem, which is not unique to Alaska. We should be working together. The Legislature did not ask the opinions of the Boards before they introduced these bills. My late colleague, Bob Boko, a respected member of the Fairbanks Community, was not in favor of a Defined Contribution program. He knew it would be devastating to seniors. Though he chaired the Tier Committee and voted to recommend Option One of their proposed plan, he did so only because the Administration put pressure on him. After the vote in November, he wanted to meet and confer with the Joint Board members after our meeting with ASPIB on December 1st. He

wanted to discuss the suggestions we all had made. We were not allowed to meet. I urge you to speak with his widow, Sharon, who shares his deep concern.

Please let us work together to make Alaska a place where young people want to come and work. We can be a role model for health care reform if we choose to work together. I do not like the word "impose"; I prefer sitting down and discussing the problem and developing a solution which works for all. Thank you for your time.

DRAFT

OUTLINE OF MAJOR POINTS FOR TESTIMONY

BEFORE ALASKA LEGISLATURE, MARCH 29-31, 2005

Richard J. Solie, TRS Board Member

-- My name is Richard Solie, Sr. I am retired from the University of Alaska where I was a Professor of Economics, Head of the Department of Economics, and Acting Dean of the School of Management. I also ran my own economic consulting firm for a number of years.

I am a member of the TRS Board, having been appointed by Governor Murkowski in the summer of 2003 and re-appointed to a new term in January of 2004. As a member of the TRS Board I served as one of four members on the Tier Committee which was charged with developing a proposal or proposals for a new retirement plan for both TRS and PERS.

After review of several of the major bills being considered by the House and Senate, I have a number of observations that I would like to make. I will deal with these under several different categories, and I will approach them in order of my perception of their importance. That way, if I run out of time, I'll at least have been able to discuss what to me are the most important issues.

I. MEMBER CONTRIBUTIONS:

A. Equal sharing of "Normal Cost":

1. I, personally, agree philosophically with this approach, and, as a matter of fact, the Tier Committee's recommendation for both Alternatives 1 and 2 included employee contributions which were at least as high as the employer contributions! (TRS: Employer -- 8.75%, Employee -- 10.0%; PERS - Both pay 8.0%).
2. I even agree philosophically with equal sharing of "Normal Cost" for employees covered under existing tiers, however I am concerned that the 5%/year possible increase is a very stiff increase for an individual employee. That probably wouldn't come into play, however, if the equal sharing was limited to "Normal Cost";

3/29/2005 Partially Presented 3/30/05

3. I might note that the employee survey conducted by the Division of Retirement at the request of the Tier Committee indicated a willingness on the part of some of the employees to make higher contributions if the DB plan could be retained in a future tier; and there was wide-spread feeling among employers that employees should pay a larger share of benefit costs than they presently do;
4. I am concerned about the response of the judiciary if this is applied to existing tiers, and this is one of the reasons that the Tier Committee didn't consider this alternative;
5. I also question whether the contributions should be the same for all existing tiers:

-- "Normal Cost" for TRS Tier II in FY06 is 20.36% versus a 22.97% combined rate for Tiers I & II (p. 8, slide 15, November 19, 2004 Presentation to PERS and TRS Boards).

- "Normal Cost" for PERS Tier III is 17.55% versus 20.05% for Tiers I, II and III combined (slide 14)

B. Equal sharing of contributions for "Past Unfunded Liabilities":

1. For members of a new tier, there would, of course, be no unfunded liabilities so presumably it isn't the intent of the legislature to charge them for the unfunded liabilities of existing tiers;
2. For current TRS/PERS members I am strongly opposed to such a policy for several reasons:

- a. The majority of the past funded-liabilities are associated with retirees rather than with current actives;

- b. Bob Reynolds with Mercer estimated the allocation of unfunded liabilities to be approximately:

-- TRS – 27.8% active participants, 68.5% for retirees and beneficiaries, 3.2% for terminated vested individuals and 0.5% for "others" (thus 72.2% for non-actives);

-- PERS – 33.2% actives, 11.7% terminated vested, 54.7% retirees and dependents, and 0.4% "other" (66.8% for non-actives)

c. Furthermore, you would get a similar disparity even among the actives since a newly hired employee would have essentially no unfunded liability related to his future benefits whereas a long-term employee who was nearing retirement would have a great deal.

d. The result would be that existing members would be required to pay additional contributions that would be grossly out of line with the future benefits they could be expected to receive.

II. INTRODUCTION OF A 100% DC PLAN TO REPLACE THE EXISTING DB PLAN

- A. First of all, let me say that I am not opposed to the general concept of DC plans or of privatized retirement plans. I strongly believe in individual responsibility and in the advantages of personal ownership of private equities;
- B. I am sure that all of you are aware that, although the Tier Committee did forward to the full boards an Alternative 2 which was 100% DC, the committee was unanimous in opposing its adoption;
- C. I personally pressed for a hybrid plan that included both a 1% DB and a DC component. Although some of the committee members undoubtedly had misgivings about it, there was a clear recognition of the serious problem facing the State of Alaska with respect to the retirement plans, and consequently the Tier Committee voted unanimously to support the hybrid plan;
- D. There are several reasons for the committee's and my personal opposition to a 100% DC plan:
1. A key factor is that in Alaska most of the teachers in this state are not covered by Social Security. Thus, they lack the floor of retirement benefits that is available to private sector employees and to public sector employees in most other states. The 1% DB plan that the Tier Committee proposed would provide such a floor.
 2. The employer surveys that were conducted showed strong support for a sharing of the risks of the retirement plan, not a complete shifting of the risk to the employees;

3. The vast majority of other public employment plans are 100% DB plans; a much smaller number are hybrid plans with both DB and DC components; and some include an optional DC plan. Only a handful are 100% mandatory DC, and this could be a significant factor in competing for employees;
4. I am sure you have been exposed to the studies showing significantly lower rates of return on individually managed versus pooled accounts and also the problem with some employees utilizing their retirement funds for purposes other than retirement. As a consequence, I won't discuss those issues
5. Individual investors face risk that is significantly greater than that for a pooled investment plan for several reasons:
 - a. The volatility of the markets is such that there is a significant possibility that an individual's planned retirement will coincide with a down market. And, while there might be some possibility for a postponement of the planned retirement, I would call attention to the fact that the U.S. stock markets generally reached their previous highs in March of 2000 and five years later the S&P 500, for example, is still approximately 25% below the March of 2000 peak
 - b. The pooled funds, of course, are subject to similar volatility, but in any given year only a small fraction of the members are planning to retire, and as a consequence the pooled funds have a much longer time horizon in which to recover from those downturns
 - c. When it comes to actual retirement, the longevity factor is very significant for the individual retiree, but it is largely limited by the pooling that results with a large fund (By this I mean that for an individual, the number of additional years that he/she will live after retirement is very uncertain. Thus, there is a significant risk of outliving one's retirement funds. For a large group, in contrast, the average risk is minimal because of the large numbers of individuals involved. This, of course, is what creates the opportunity for life insurance.)

d. The suggestion could be made that when the individual retires, he/she could buy a whole-life annuity which would shift the risk to an insurance company. The problem with this is that annuities are very much a function of interest rates at the time they are written, and consequently a period of low interest rates would result in a much smaller annuity for an individual retiree. Again, the pooled retirement fund is able to take a much longer view of interest rates.

6. Largely as a result of issues such as these, the State of Nebraska, recently switched from the DC plan that it had maintained for 25 years to a Defined Benefit plan.

7. In most states where employees have been given the option to choose between a DC and a DB plan, the overwhelming majority have chosen the DB option. In Florida, for example, only 3% of the employees chose the DC alternative, and in Ohio only 7,367 of almost 300,000 employees chose the DC plan. (Source: *Public Pension Action News*, Spring 2003.)

- This, I believe, is a strong indicator of the negative impact that a 100% DC plan would have on our competitiveness in attracting and retaining teachers and other public employees in the future.

8. I am aware that there is a movement in some states to replace their DB plans with either hybrid plans or, in some cases, with 100% DC plans. Given the problems already facing the State in attracting and retaining employees, I am not sure that it is wise for Alaska to get into the lead on this movement.

III RE-CONSTITUTION OF AND/OR ELIMINATION OF THE EXISTING BOARDS:

A. In my opinion, the proposed increase in professionalism would be positive, although I have been impressed with the expertise and experience already existent on the Boards.

B. I am concerned about the lack of assured representation of TRS/PERS members in some of the bills – after all, the monies in the funds are held in trust for the members; the members have made major contributions into the funds; and the funds represent the major (and in some cases the total) basis for their future retirement.

- Further, even if there is assured member representation, there is a question as to whether public or member's representatives should hold the majority (I would personally favor the members' representatives being in the majority.).

C. Role of PERS/TRS Boards in appeals:

- Hearing Officer would probably be more efficient if efficiency is measured only by the hearing itself. But, 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 case has been truly heard.

-- I was a member of the National Panel of Arbitrators of AAA for a number of years, and I feel that that system (which in a majority of the cases relies on a single arbitrator) works well.

- There is a major distinction between that system and the one envisioned here, however. The arbitrator is jointly selected by the parties and thus there is basis for trust and confidence on both sides of the issue being appealed
- In this instance, I am afraid that the fact that the Hearing Officers would be administratively appointed would engender potential distrust on the part of the appellants;

D. Some of the functions envisioned for a "Super Board", while probably well within their capabilities, would add significant and potentially time-consuming duties to the already heavy responsibility of overseeing investment of the funds.

E. I am sure some of my colleagues have discussed the loss that a "Super Board" might engender in some of the inputs currently realized from the existing TRS/PERS boards (e.g., recommendations for health plan cost savings from the Health Sub-committee) so I won't go into that.

IV. PROPOSED CHANGES IN THE HEALTH PLAN:

- A. As you are all aware, the health plans have been a **major contributor** to the unfunded liability for the Alaska TRS and PERS. Further, unlike the impact of the downturn in the securities markets—which will probably even out over time—there is really no end in sight for the health plan problems. As a consequence, the Tier Committee (and a majority of the TRS/PERS Boards) considered it to be absolutely essential that the administration and/or the legislature make significant changes in the current plan. Such changes should be designed to reduce both plan costs and future risk.
- B. The Tier Committee's proposal included several major changes for employees under a new tier:
 1. Participation in the health plan would require retirement directly from employment.
 2. The plan would be redesigned to include true deductibles and co-pays for Medicare eligible retirees. This is not true under the existing plan, and the situation that exists at present provides essentially no incentive for such retirees to monitor and ration their health care usage and costs.
 3. The plan would provide for significant health plan premium payments by the retirees tied to the length of the employee's service and to whether they were taking early or normal retirement:
 - a. Access only to coverage with full premiums paid by the retiree would apply during early retirement;
 - b. A DC type of employer subsidy for premium payments would be provided during normal retirement and up to Medicare eligibility;
 - c. Employees would pay a percentage of actual plan costs upon reaching Medicare eligibility with the percentage varying in accordance with the employee's years of service.

4. As a means of assisting retirees with the payment of the larger deductibles and co-pays as well as the retiree premium payments, an Employer paid for Health Savings Account would be provided. At the same time that this would assist retirees in paying the larger share of health plan costs it, **along with the higher deductibles and co-pays, would provide the retiree with a strong incentive to assist in controlling health care expenses.**

C. I am aware that Senate Bill 141 appears to provide similar changes to those outlined above for retirees who have reached Medicare eligibility. I am also aware of the HSA provisions in most, if not all of the various legislative bills. I am concerned, however, about several provisions:

1. For retirees from age 60-Medicare eligibility there is no subsidy (other than what might provided by the HSA). I am somewhat disappointed in this since I believe that the Tier Committee's age 60-Medicare eligibility subsidy would have involved essentially no risk to the employer (The subsidies are fixed in initial amount and in terms of future increases, and they would be readily calculable.) and the cost would have been relatively low.
2. The HSA contributions are capped at \$500 per year. There is concern that this would produce an inadequate fund to assist in the retiree's uncovered health care expenses.

V. ELIMINATION OF THE 10% COLA:

-- As you are aware, the Tier Committee recommended elimination of the 10% COLA for the new tier.

- Our reason for eliminating COLA for the new tier was our recognition of the current court action challenging the application of the existing COLA and seeking to apply it to retirees living outside the State in areas which have living costs equal to or greater than those in Alaska;
- We did feel, however, that the COLA (unless the legal challenge is successful) does serve a public purpose by encouraging retirees to remain in Alaska.

VI. ADDITIONAL POTENTIAL CHANGES APPARENTLY NOT CONTEMPLATED IN CURRENT LEGISLATION:

- A. Although the Tier Committee did not formally recommend it, there was considerable discussion about proposing the elimination of SBS. This could mean many millions of dollars in savings to the State and other employers which could be used to help fund the existing retirement programs as well as the benefits of a new tier.
1. In considering this, the Tier Committee was aware that, although the State and University of Alaska are covered by SBS, a number of the political subdivisions are not. Thus, eliminating SBS would also be a means of rationalizing the statewide retirement benefits structure.
 2. The specific reason that this was not proposed by the Tier Committee was a caution by the Boards' legal counsel that the courts might view SBS as a contractual obligation paid in return for the agreement to opt out of Social Security.
 3. The legislature, however, is in a position to get a thorough review of the legal issues involved in such a change, and if the determination is that it would pass judicial scrutiny, I (and I believe I speak for the majority if not all of the Tier Committee and also for several of the other Board members) would recommend that this be given consideration for a future tier.
- B. As you are aware, the Tier Committee recommended the adoption of a "career average" base salary (adjusted for changes in the Alaska CPI) under the new tier in contrast to the "High Three Years' Salary" that is the basis for pension calculations at present.
1. This, of course, is irrelevant if the legislature adopts a 100% DC plan, but if a hybrid plan is approved, it could be very important.
 2. A career average salary would eliminate many of the so-called "abuses" of the system under which various actions are taken to build up the final three years of salary.
 3. A career average base would allow such things as inclusion of overtime pay, bonuses, etc. without distorting the benefits and creating unfunded liability as currently occurs when such elements are added in the final three years. Allowing them to be included, however, would give employers maximum flexibility in using these as tools for managing their workforce.

*copy for comm.
Wed 3/31/05*

Good Morning . My name is Gayle Harbo and I have been a resident of Alaska since 1957. I am a mother, a grandmother and a teacher and most recently a member of the Teacher Retirement System Board. As a parent and a grandmother I am most concerned about the quality and stability of the education employees in the state of Alaska. When I came to Alaska there were many applicants for each job, with prospective teachers often subbing for years before they were hired to a permanent position. Salaries in the late '60's and early '70's were very competitive. That is no longer true. I believe teacher job fairs are no longer held in either Anch or Fairbanks. The point is Alaska is no longer the place to come to get a good salary . A friend in Wasilla said if she had stayed in Wisconsin for her teaching career she would have a better retirement then she will have here.

I want the best and brightest to teach my grandchildren. To attract teacher's it is important we keep the DB system. Many of the changes recommended by the Tier Subcommittee of the Joint BDs could be adopted without going to a defined contribution system. One, in particular, would change the number of years over which an average salary is computed.

It is important to realize that, under the proposed system, seniors would be given a "pot" of money when they retire and then have to manage a resource that is to last them for a lifetime in terms of annual income. They would have no inflation proofing(PRPA, which even SS provides)and they would be at the mercy of investment advisors and unknown investment costs. As individuals, they would not be able to get the breaks ASPIB gets by investing large sums of money, putting their dollars at even greater risk. You have all read the horror stories of retirees who have lost everything because they did not have the expertise to invest. Most are emotional, not long term investors and their resources may not match their lifetime expectancy.

Another issue for seniors is health. I personally know many seniors who have suffered from stroke, Parkinson's, and dementia in their late 60's and early '70's. Who will look out for their well-being and security? Our retirees who invest their lives working for the state of Alaska deserve more.

The proposed legislation is particularly unfair to members of TRS who were pulled from Social Security, but not given the option PERS employees received when SBS was formed and the state matched the employee contribution of 6.13% . In addition PERS employees may participate in a

deferred comp plan. Teachers not only do not have a parallel SBS plan, they often receive little or no benefits under Social Security because of the provisions of the Government Pension Offset (spousal offset) and the Windfall Elimination Provision. These provisions eliminate or greatly reduce promised benefits from Social Security for quarters worked. Not only that, because the state mandates participation in Medicare Part B when a retiree reaches age 65, every retiree must pay almost \$80 a month out of pocket.

Last year this Legislature unanimously passed a resolution requesting our Alaska Delegation in Congress work for the repeal of GPO/WEP. They recognized the inequities for public employees not covered by SS.

I urge you to give this matter more thought before you make sweeping changes. Let's work together for a year to get the health care costs down and look at some of the suggestions made by the Joint Boards at the presentation of the Tier subcommittee's proposal in November. I am sure working together we can reach a solution that will be beneficial to future employees and also to Alaska's children. I want young people to come to Alaska and to stay in Alaska. We have much to offer. Thank you for this opportunity.

Gayle W. Harbo, JR.

A
EARNINGS FOR TRS RETIREMENT CALCULATIONS

AVERAGE ANNUAL RATE OF INCREASE:
 ANCHORAGE CPI (1): 3.730% ASSUMED YRS AK SERVICE: 25
 AVE ALASKA ALL INDUSTRIES WAGE (2): 3.910% BEGINNING SALARY (3): \$37,538.00

AVERAGE BASE RETIREMENT SALARY DETERMINED BY: % of High 3
 ALL YEARS WITHOUT ADJUSTMENT: \$68,925.73 65.89%
 ALL YEARS ADJ BY ANCHORAGE CPI: \$102,109.67 97.61%
 ALL YRS ADJ BY AK MNTHLY EARNINGS: \$104,203.48 99.61%
 HIGH FIVE YEARS: \$100,481.01 96.05%
 HIGH THREE YEARS: \$104,611.64 100.00%

| (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) | (9) | (10) |
|------|-----------------|------------------|-----------------------|-----------------------------|---|-------------------------------------|--------------------------|------------------------|--------------------------|
| YEAR | EMPLOYMENT YEAR | BEGINNING SALARY | SALARY INCREASE % (4) | PROJECTED ANCHORAGE CPI (5) | PROJECTED ALASKA ALL INDUSTRIES AVE MO EARN (6) | ANNUAL BASE SALARY ADJUSTED TO DATE | | | |
| | | | | | | BASED ON ANCH CPI (7)* | BASED ON AK AVE EARN (8) | BASED ON HIGH FIVE (9) | BASED ON HIGH THREE (10) |
| 2004 | 1 | \$37,538.00 | 5.730% | 1.686 | \$3,301.81 | \$90,401.62 | \$94,242.63 | N/A | N/A |
| 2005 | 2 | 39,688.93 | 5.730% | 1.748 | 3,430.91 | 92,144.63 | 95,893.31 | N/A | N/A |
| 2006 | 3 | 41,903.10 | 5.730% | 1.814 | 3,565.06 | 93,921.26 | 97,572.89 | N/A | 39,730.01 |
| 2007 | 4 | 44,367.59 | 5.730% | 1.881 | 3,704.45 | 95,732.14 | 99,281.90 | N/A | 42,006.54 |
| 2008 | 5 | 46,909.85 | 5.730% | 1.952 | 3,849.30 | 97,577.93 | 101,020.84 | 42,093.49 | 44,413.51 |
| 2009 | 6 | 49,597.79 | 4.230% | 2.024 | 3,999.81 | 99,459.32 | 102,790.23 | 44,505.45 | 46,958.41 |
| 2010 | 7 | 51,695.77 | 4.230% | 2.100 | 4,156.20 | 99,938.73 | 103,106.78 | 46,906.82 | 49,401.14 |
| 2011 | 8 | 53,882.50 | 4.230% | 2.178 | 4,318.71 | 100,420.46 | 103,424.31 | 49,290.70 | 51,725.35 |
| 2012 | 9 | 56,161.73 | 4.230% | 2.259 | 4,487.57 | 100,904.50 | 103,742.81 | 51,649.53 | 53,913.34 |
| 2013 | 10 | 58,537.37 | 4.230% | 2.344 | 4,663.03 | 101,390.88 | 104,062.30 | 53,975.03 | 56,193.87 |
| 2014 | 11 | 61,013.51 | 4.230% | 2.431 | 4,845.36 | 101,879.61 | 104,382.77 | 56,258.18 | 58,570.87 |
| 2015 | 12 | 63,594.38 | 4.230% | 2.522 | 5,034.81 | 102,370.69 | 104,704.22 | 58,637.90 | 61,048.42 |
| 2016 | 13 | 66,284.42 | 4.230% | 2.616 | 5,231.67 | 102,864.14 | 105,026.67 | 61,118.28 | 63,630.77 |
| 2017 | 14 | 69,088.25 | 4.230% | 2.713 | 5,436.23 | 103,359.96 | 105,350.11 | 63,703.59 | 66,322.35 |
| 2018 | 15 | 72,010.68 | 4.230% | 2.815 | 5,648.78 | 103,859.18 | 105,674.54 | 66,398.25 | 69,127.78 |
| 2019 | 16 | 75,056.74 | 4.230% | 2.920 | 5,869.65 | 104,358.80 | 105,999.98 | 69,206.89 | 72,051.89 |
| 2020 | 17 | 78,231.63 | 4.230% | 3.029 | 6,099.16 | 104,861.83 | 106,326.41 | 72,134.34 | 75,099.68 |
| 2021 | 18 | 81,540.83 | 4.230% | 3.141 | 6,337.63 | 105,367.28 | 106,653.86 | 75,185.63 | 78,276.40 |
| 2022 | 19 | 84,990.01 | 4.230% | 3.259 | 6,585.43 | 105,875.18 | 106,982.31 | 78,365.98 | 81,587.49 |
| 2023 | 20 | 88,585.09 | 4.230% | 3.380 | 6,842.92 | 106,385.52 | 107,311.77 | 81,680.86 | 85,038.64 |
| 2024 | 21 | 92,332.24 | 4.230% | 3.506 | 7,110.48 | 106,898.32 | 107,642.24 | 85,135.96 | 88,635.78 |
| 2025 | 22 | 96,237.89 | 4.230% | 3.637 | 7,388.50 | 107,413.59 | 107,973.74 | 88,737.21 | 92,385.07 |
| 2026 | 23 | 100,308.75 | 4.230% | 3.773 | 7,677.39 | 107,931.34 | 108,306.25 | 92,490.80 | 96,292.96 |
| 2027 | 24 | 104,551.81 | 4.230% | 3.913 | 7,977.58 | 108,451.65 | 108,639.79 | 96,403.16 | 100,366.15 |
| 2028 | 25 | 108,974.36 | 4.230% | 4.059 | 8,289.50 | 108,974.36 | 108,974.36 | 100,481.01 | 104,611.64 |
| 2029 | 26 | 113,585.97 | 4.230% | 4.211 | 8,613.62 | #N/A | #N/A | 104,731.36 | 109,036.71 |
| 2030 | 27 | 118,388.57 | 4.230% | 4.368 | 8,950.41 | #N/A | #N/A | 109,161.49 | 113,648.97 |
| 2031 | 28 | 123,396.41 | 4.230% | 4.531 | 9,300.38 | #N/A | #N/A | 113,779.02 | 118,456.32 |
| 2032 | 29 | 128,616.08 | 4.230% | 4.700 | 9,664.02 | #N/A | #N/A | 118,591.88 | 123,467.02 |
| 2033 | 30 | 134,056.54 | 4.230% | 4.875 | 10,041.88 | #N/A | #N/A | 123,608.31 | 128,689.67 |
| 2034 | 31 | 139,727.13 | 4.230% | 5.057 | 10,434.52 | #N/A | #N/A | 128,836.95 | 134,133.25 |
| 2035 | 32 | 145,637.59 | 4.230% | 5.246 | 10,842.51 | #N/A | #N/A | 134,266.75 | 139,807.08 |
| 2036 | 33 | 151,798.06 | 4.230% | 5.441 | 11,266.45 | #N/A | #N/A | 139,967.08 | 145,720.92 |
| 2037 | 34 | 158,219.11 | 4.230% | 5.644 | 11,706.97 | #N/A | #N/A | 145,887.68 | 151,884.92 |
| 2038 | 35 | 164,911.78 | 4.230% | 5.855 | 12,164.71 | #N/A | #N/A | 152,058.73 | 158,309.65 |

Provided by Mr. Solie
3/31/05

Good morning. My name is Chris Blust. I have worked for the Juneau School District as a para educator for eleven years. I moved to Juneau 12 years ago this coming August. I moved here for several reasons, the first being the opportunity to raise my then 10 year old daughter in a place where she could ride her bicycle down the path and not have to worry that some lunatic was going to snatch her, never to be seen again. My husband and I longed for a safer life for all of us. I also moved here because of the awesome beauty, clean air, clean water and abundant wild life. I have never regretted it, not for a second. I moved here to improve the quality of life for my family and myself and I seen all of this come to pass. I love Alaska, Juneau in particular, and I can't see myself ever leaving, this is my home.

The first year I lived here I took a job with the Juneau School District. I am what is now called a para-educator. If you aren't familiar with that term, ten years ago I was a classroom aide, then a teaching assistant and now a para. The title changed, the pay didn't., darn. At that time, I was able to take a classified job and make almost as much as I did as a new teacher in California. But what I really wanted was a job with good medical insurance and a good retirement. You see, my husband is self-employed and does not have those benefits. My insurance was adequate, the retirement okay. The salary was enough and I knew that there would be regular step increases and I expected that my salary would raise with the cost of living. I was in for a surprise.

During the last eleven years, five of those found my wages frozen. The school district was having to tighten their belts, there was no money for steps, there was no money for raises.. Our insurance was still good, that was good compensation. Then three years ago Blue Cross Blue Shield presented the District with a 62% increase in insurance costs, if we wanted to continue with the same coverage. That was impossible. What we ended up doing was gutting the plan, it became a plan that we could no longer afford to even use. Catastrophic insurance. We now had a \$500 deductible per family member. We paid 30% instead of 20% on our co-pay and our prescription plan went out the roof. By doing this we were able to keep members from having a co-pay. But the next year the insurance went up 18% and we were told by our broker that we could expect this each and every year, it was the TREND. Don't you just hate that word? We were fortunate that the District was able to cover this increase but at negotiations they made it clear that they could not continue to do so and every year we would be faced with those rising costs. And indeed this came to pass and during the last negotiations, the classified staff had to pick up \$70 per month to help the cost. Our union is very proactive. Faced with these rising costs we began to educate members on how to shop for services, how to get the most from any money spent, but for many, it simply meant we no longer had the luxury of going to the doctor, the chiropractor, the dentist. It was no longer an option. Working with APEA we developed our own health trust to better managed the costs. All this work done by volunteers. But we know there are no guarantees, we don't know how long we can fight the TREND. This last Contract I received my first real increase in pay. I got my 3% step increase and a 2% for the first year of the Contract and a 1% the next year. We will be back in negotiations this November. It doesn't look good.

I'm telling you this sad story as a prelude to my and your reason of being here today. Today, I pay to PERS 9.6% of every check. I pay extra to fill in the three months I am off during the summer. I was here yesterday listening to the testimony and I heard it debated that I, as the employee needed to take more responsibility in my retirement. I heard that it was time for the employer to not have to carry the burden of retirement after those workers had "foolishly" spent their money and had not thought far enough ahead to see the price of their folly. Senators, I, and my fellow classified don't spend out money foolishly, we do it to pay the rent, the utilities, food, clothing...we are not being irresponsible, we are living from pay check to pay check. There are many school district employees who have two, some even three jobs to support their families. We have full-time employees who, because of their rising medical costs live in Section Eight housing. Retirement isn't a priority, these people will never be able to retire, they must work until physically no longer able, or just do the right thing, and die. I have no expectation of retaining my life-style and current living standard. Things will change and I will have to just deal with it. For some school district employees, their future is much more grim.

testified 3/22/05

I would like for you to look at the numbers and tell me what more I can do. If 141 is made into law, I could be looking at 14.6% being taken next year for PERS, along with a 12% increase in my health insurance. The next year I could look at 19.6% being taken from my check, along with a 12% increase in insurance. In three years I would be looking at a 24.6% increase in my PERS contributions....need I say more?

I understand the fix you as legislators are in. Balance the budget, be responsible, do your job. I don't have a solution for you but as you ponder on this issues, please do not forget my message today, do not forget those who don't have time to spare, do not forget my face. Your actions will affect my fellow employees and they could be devastating. Thank you for the opportunity to speak to you today. This is one another thing I love about Alaska.

CITY & BOROUGH OF JUNEAU SCHOOL DISTRICT
 10014 CRAZY HORSE DRIVE
 JUNEAU, AK 99801
 (907) 463-1700 ext 437

Direct Deposit Voucher
 FIRST NATIONAL BANK ALASKA
 JUNEAU ALASKA

89-6/1252 No. 33974

| DATE | CHECK NUMBER |
|---------|--------------|
| 3/18/05 | 33974 |

| DIRECT DEPOSIT AMOUNT |
|-----------------------|
| *****\$896.96 |

PAY

VOID VOID VOID VOID

Direct Deposit
 Voucher

NON-NEGOTIABLE

TO THE ACCOUNT OF
 36
 JULIA J. BLACK
 4544 TRAFALGAR AVE
 JUNEAU AK 99801

JUNEAU SCHOOL DISTRICT

⑈00033974⑈ ⑆125200060⑆ 0680 166 6⑈

CITY & BOROUGH OF JUNEAU SCHOOL DISTRICT
 10014 CRAZY HORSE DRIVE * JUNEAU, AK 99801
 (907) 463-1700 ext 437

No. 33974

Retain For Your Records

| | | | |
|------------------|---------|--------|----------|
| Check Date: | 3/18/05 | Check: | 33974 |
| Period End Date: | 3/06/05 | Run #: | 6737 |
| BLACK, JULIA J. | | Fiscal | Calendar |
| | | | Current |

| | | | | |
|----------------------------|---------|-----------|----------|----------|
| Non current paid-to-date | | 4,377.22 | | |
| SPECIAL ED. INST. ASSIST.- | | 16,273.43 | 7,024.50 | 1,170.75 |
| --Reg: 75.0000 HOURS @ | \$15.61 | \$1170.75 | | |
| TAXABLE LEGAL TRUST FUND | | 70.00 | 30.00 | 5.00 |
| TAXABLE GTL = \$50,000 | | 32.50 | 15.00 | 2.50 |
| Total Pay | | 20,753.15 | 7,069.50 | 1,178.25 |

| | | | | |
|----------------------------|--|---------|---------|-------|
| RETIREMENT-PERS 6.75% | | | 474.18- | 79.03 |
| SOCIAL SECURITY TAX W/H | | | 438.30- | 73.05 |
| MEDICARE TAX W/H CLASSIFIE | | | 102.48- | 17.08 |
| FEDERAL INCOME TAX W/H | | | 482.70- | 80.45 |
| WORKERS COMPENSATION | | | | .00 |
| DUES-JESS APEA | | 376.46- | | 22.18 |
| DUES-JESS | | 28.00- | | 2.00 |
| HLT INS-JESS AFTER-TX 9/10 | | 574.87- | | .00 |
| DEPENDENT LIFE - JESS | | | | .00 |
| LIFE INS-JESS BASIC 9/10 | | | | .00 |
| TAXABLE GTL = \$50,000 | | | 15.00- | 2.50 |
| TAXABLE LEGAL TRUST | | | 30.00- | 5.00 |

| | | | |
|------------------|---------|-----------|--------|
| Total Deductions | 979.33- | 1,542.66- | 281.29 |
| NET CHECK | 33974 | | 896.96 |

Tax Marital Status: S Exemptions: 03 Location: 36 36 36
 Deposited with: DENALI ALASKAN CREDIT UNION Account: 4560043886 32

| Absence/Leave Summary | Beg Bal | Earned | Absence | Adjust | Balance | HOUF |
|-----------------------|---------|--------|---------|--------|---------|------|
| ANNUAL LEAVE-CLASSIF | 59.5320 | 6.9800 | .0000 | .0000 | 66.5120 | HOUF |
| ANNUAL LEAVE-CLASSIF | 6.8580 | .0000 | .0000 | .0000 | 6.8580 | HOUF |
| SICK LEAVE-CLASSIFIED | 8.5500 | 4.3500 | 1.0000- | .0000 | 11.9000 | HOUF |
| SICK LEAVE-CLASSIFIED | 27.0900 | .0000 | .0000 | .0000 | 27.0900 | HOUF |

Julia Black
 testified 3/22/05



217 Second Street, Suite 200 • Juneau, Alaska 99801
Tel (907) 586-1325 • Fax (907) 463-5480 • www.akml.org

March 31, 2005

Senator Lyda Green, Co-Chair
Senator Gary Wilken, Co-Chair
Senate Finance Committee
State Capitol
Juneau, AK 99811

Dear Senators Green, Wilken, and Committee Members

Thank you, and especially Senator Stedman, for the resolve and hard work that has gone into generating an approach to a major problem equally facing the State, cities, boroughs, school districts, and the university. The Alaska Municipal League supports your efforts to stabilize the cost of the PERS/TRS program. The defined contribution approach and efforts to restrict actuarially unsound access to retirement health benefits is a good method of stabilizing and adding predictability for future costs.

Approximately a year ago AML organized an ad hoc committee of elected and appointed officials from cities, boroughs, school districts, and the university. Membership on the committee has remained fairly consistent with representatives from most of the larger municipalities, a number of smaller ones, a number of school districts, and the university. AML has also done extensive information and analysis work with municipalities, legislators, and the news media over the past year informing them of the problem and the need to take action.

Taking action on the PERS/TRS issue is one of AML's top two priorities in its 2005 Legislative Platform. The issue is also the subject of a separate AML resolution adopted last November and is extensively treated in the AML Policy Statement.

In addition to regular meetings throughout the year, the ad hoc committee has met several times in the past two weeks. As you know, trying to make 800 local elected officials plus managers and finance officers fully knowledgeable about a bill as complex as the PERS/TRS bills is not an easy task. Attached are comments and recommendations on the bill from the ad hoc committee which are consistent with the general adopted policy of the AML.

In addition to stabilizing long-term future costs, it is absolutely essential that the State assist cities and boroughs in meeting the skyrocketing costs of PERS for FY 06 and FY

07. The PERS costs alone over the next several years will require 1 to 6 mill property tax increases in your communities, or deep local cuts. (Each 5% annual PERS increase represents an average 3.75% overall budget increase for most communities, excluding local contribution to schools, each year.) PERS increases on top of huge increases in fuel, transportation, insurance, etc. will make it difficult to impossible for many of your communities to raise local taxes enough to pay the requested local contribution for schools, plus roads, public safety, and other key local services. In addition, the State, according to State reports, has already lost 9 of its 94 small cities with the likely loss of many more by next year. This represents a large increase in State liability in its Unorganized Borough, the loss of critical public services to Alaskans, and an enlarging hole in the economic fabric of the State that will not be easy to repair. The State has the resources necessary to help stabilize local taxes and services, and AML suggests that this should be a legislative priority that will help your constituents. The PERS help to your communities for FY 06 and FY 07 is critical.

Thank you.

Sincerely



Kevin Ritchie

Executive Director

AML Position on SB 141

Key Cost Driver of PERS/TRS

According to the Division of Retirement and Benefits/Mercer Consulting:

- Individually, the retirement compensation portion of PERS/TRS is adequately funded. The funding problem is in the post-retirement Health Insurance.
- Approximately 75% of the cost of the PERS/TRS health program is for retirees who have not yet reached 65 year of age, and only 25% of the cost is for post-65 age retirees.

Health insurance is the fastest growing cost to PERS/TRS. It appears that access to full health benefits, especially for retirees younger than 65, is the largest cost driver of the \$5 billion system shortfall and a key consideration for the future.

Overall Policy on SB 141

AML supports the adoption of a new PERS/TRS "Tier" of benefits for new employees that:

- Better controls future costs, especially health insurance, of the PERS/TRS system for employers, and;
- Provides benefits that allow employers to attract and retain good public employees. It is recommended that the adequacy of proposals be compared and determined by:
 - Comparison with other states and likely competitors for employees, and
 - Developing test cases for retirement benefits for retirees of various incomes and years in the system considering

Defined Contribution

AML members generally support a defined contribution approach to a new "tier." Regarding the amount of the defined contribution, if a municipality feels that state compensation benefits are too low, any municipality may independently supplement the employee's retirement with federally approved deferred compensation retirement programs. The suggestion of Senator Stedman to put some type of investment earnings floor into the DC plan would reasonably share the risk of long-term down markets with employees.

Health Benefits

Since health is the primary cost driver of the current funding problem, AML supports changes to control health program costs by limiting access to full health benefits and ensuring that health benefit costs are actuarially covered by employer/employee contributions. The proposal that employees must retire from the PERS/TRS system to access health benefits will significantly limit access, especially in cases when the employee/employer contributions have not provided enough contributions to pay for an individual's retirement health benefits. For example, the old practice of providing full retirement health benefits at age 55 after only five years of employment is not an actuarially sound practice. AML also supports the Health Reimbursement Accounts. Again, the level of health benefits must be considered for adequacy. It appears that the Mercer proposal provided greater health benefits from age 60 to 65 than proposed in SB 141. It may be that the system can be protected by allowing access to health benefits with an expanded sliding scale for employees who do not retire out of the system.

Board

AML supports restructuring of the PERS/TRS board to improve employer participation. Municipalities, Schools, and the University represent 63% of the PERS/TRS programs but have never had direct representation on the PERS/TRS Boards. This is a critical accountability issue. In the past, there was no direct link between the PERS/TRS boards and most employers. This resulted in a loss of involvement and accountability on the part of municipalities, school districts and the University. It is recommended that:

- Direct accountability be established either by providing for direct appointment by each employer group collectively, or providing three names for each position to the Governor, and
- Increase the size of the proposed board to 11 and add one additional municipal and one additional school district representative and one University representative to mirror the composition of the PERS/TRS program.
- Since schools and the UA have both PERS and TRS employees, it may make sense to merge the current PERS and TRS boards. (But not necessarily the investment board.)

Strengthen the Review and Analysis Process for changes in the future

A significant portion of the unfunded liability is due to hurried and inadequate analysis of the long-term cost of modifications to PERS/TRS. Unlike any other legislative decision, under Alaska's Constitution a PERS/TRS benefit can never be "diminished or impaired" (Article XII, Section 7). The current "fiscal note" process for bills is not sufficient to accurately determine the long-term impacts of changes. Over a long time period the lack of an adequate analysis process has been the cause of a significant portion of the current cost crisis. Implement:

- A statutory 90 day review process prior to legislative committee review that includes,
 - A comprehensive long-term actuarial analysis by the PERS/TRS Boards, and
 - PERS/TRS hearings with all affected employers, and
 - A full report and recommendation of the PERS/TRS Boards to the legislature.

Short and long-term financial solutions to meet crushing cost increases for past liability

While it is important to create a new "tier" to control future costs, it does nothing to reduce the problem – skyrocketing payments for past liability. It is recommended that

- a. Support State appropriations to offset the 5% PERS/TRS cost increase for FY 06 and the cumulative 10% cost increase for FY 07.
- b. Consider the long-term cost impacts a direct pay down of the approximately \$5 Billion past liability. For example, a \$2 Billion pay down could lower long-term PERS/TRS rate increases significantly.
- c. Consider the creation of a State and Local Retirement Pension Bond Corporation to finance the PERS/TRS \$5 Billion past liability with low interest bonds. Estimated bond rates of 5.5 to 6% could save an estimated over \$100 million/year on the PERS/TRS unfunded liability currently charged to employers at 8.25%.

Accountable and Representative Board Structure

AML supports restructuring of the PERS/TRS board to improve employer participation and coordinate decision-making recognizing that schools, the university, and the state are both PERS and TRS employers.

Municipalities, Schools, and the University represent 63% of the PERS/TRS programs but have never had direct representation on the PERS/TRS Boards. This is a critical accountability issue. In the past, there was no direct link between the PERS/TRS boards and most employers. This results in a loss of involvement and accountability on the part of municipalities, school districts and the University.

% of PERS/TRS program

| | |
|-------------------------------|-------|
| State | 38% |
| Schools - (Both PERS and TRS) | 34.5% |
| Cities and Boroughs | 19% |
| University | 8.5% |

Draft language: (p.37 of SB 141)

(b) The Alaska Retirement Management Board consists of ~~nine~~ eleven trustees. The commissioner of administration and the commissioner of revenue shall serve on the board. The governor shall appoint seven additional trustees who meet the eligibility requirements for an Alaska permanent fund dividend and who are professionally credentialed or have recognized competence in investment management, finance, banking, economics, accounting, pension administration, or actuarial analysis as follows:

- (1) three trustees shall be appointed from the general public; a trustee appointed under this paragraph may not hold another state office, position, or employment and may not be a member or beneficiary of a retirement system managed by the board;
- 2) Two one trustees, at least one shall be employed as a finance officer, for a political subdivision or the university participating in the public employees' retirement system. The governor shall solicit three names for each position from organizations representing political subdivisions and the university;
- 3) Two one trustees, at least one shall be employed as a finance officer, for a political subdivision or the university participating in the teachers' retirement system. The governor shall solicit three names for each position from organizations representing political subdivisions and the university;
- (4) one trustee shall be a member of the public employees' retirement system;
- (5) one trustee shall be a member of the teachers' retirement system.

Strengthen the Review and Analysis Process for changes in the future

A significant portion of the unfunded liability is due to hurried and inadequate analysis of the long-term cost of modifications to PERS/TRS. Over a long time period the lack of an adequate analysis process has been the cause of a significant portion of the current cost crisis. Implement:

The current "fiscal note" process for bills is not sufficient to accurately determine the long-term impacts of changes.

Draft language

Powers and duties of the board – (Section 42 p. 38):

Add:

8. Prior to the adoption of any benefit change to the system the board shall have a maximum of ninety days to work with the retirement system coordinator to perform a long-term actuarial analysis of any proposed benefit changes to the system, provide that information to all employers allowing adequate time to gather comments, hold at least one public hearing, and amend board recommendations, then provide a full report to the legislature and governor.



*Alaska Municipal League/Alaska Conference of Mayors
2005 Legislative Platform Priorities*

Excerpt

2. Protect Communities and local Taxpayers from mandatory State PERS/TRS Cost increases.

*Alaska Municipal League/Alaska Conference of Mayors
2005 Policy Statement
Adopted November 2004*

Excerpt

D. PUBLIC EMPLOYEES' RETIREMENT AND BENEFITS

1. **Funding of Massive Unexpected increases in PERS/TRS Costs Due to Inaccurate Projections:** To avoid penalizing local taxpayers and students, the State should take financial responsibility for the cost increases of 5% of salary each year that are clearly due to inaccurate projections.
2. **Increases in Benefits:** The League opposes any legislation that increases the cost of the Public Employees' Retirement System or the Teachers' Retirement System.
3. **Analysis of Proposed Benefit Changes:** The League strongly urges the development of a mandatory statutory process that implements a comprehensive actuarial analysis including long term impacts on the state, municipal, school district, and university members, and requires a full public and employer review/comment process under the PERS/TRS Board, prior to action by the legislature. Due to the permanent and irrevocable nature of any benefit changes in the PERS/TRS systems, benefit changes should be acted on by the legislature in the year following introduction to allow for an adequate comprehensive actuarial analysis, discussion with employers, and allow time for the public decision-making process.
4. **Stabilization of the Cost of the PERS/TRS System:** The League supports change to the PERS/TRS system that will stabilize the cost of the program to municipalities.
5. **Basis for Computation of PERS/TRS Benefits:** The League supports changes to the computation of PERS/TRS benefits to exclude overtime pay and leave cash-in from the calculation of retirement benefits.
6. **Proportionate Representation on PERS/TRS Board:** The League urges the addition of proportionate representation of municipal, school district, and university employers on the PERS/TRS Boards.

PERS Talking Points

Two Year PERS Early Funding Needed for Municipalities to Avoid Crushing Tax Increases and Allow for Planning

A Crushing Municipal Impact: Mandatory State PERS increases on top of revenue sharing/other losses and local economic recessions will leave many municipalities without the resources to fully fund schools, or other basic services:

- **Not a problem of municipal making:** PERS/TRS contributions are mandatory required by the State. In the past, municipalities have made all payments requested by the State. Municipalities, schools, and UA make up for 63% of the PERS/TRS system but these employers have no representation on the PERS/TRS Boards.
- **The bottom Line: Relying on local "Tax Authority" means:** Municipalities with property taxes face 1 to 6 mill property tax increases just to pay state mandated PERS costs over the next three years (average 1.65 mills). Many municipalities have local tax caps that preclude such increases while municipalities with sales taxes must go back to voters for sales tax increases to pay for PERS.
- **The State has far, far more fiscal capacity than communities:** Every \$1 increase in oil prices nets \$65 million more state revenue, but costs cities, boroughs, businesses and families \$20 million in higher fuel/transportation costs.
- **Problem for Alaska and municipalities to 2028 – Per the 3/04 Mercer "Actuarial Valuation Report" for 1% employee "population" annual increase:**

| | <u>*PERS Employer Rate</u> | <u>*TRS Employer Rate</u> |
|---------------|----------------------------|---------------------------|
| FY 03 | 6.77% | 11% |
| FY 04 | 11.77% | 16% |
| FY 05 | 16.77% | 38.5% |
| FY 06 | 21.77% | 39.22% |
| FY 07 | 26.77% | 40.75% |
| FY 08 to FY28 | *27.74% to 30.22% | *41.29% to 47.62% |

*These rates could increase by 10% of salary if state investment returns average one half percent less than projected. (Current projection for average investment returns is 8.25%/yr)

- **PERS/TRS Cost increases for FY 05 approved by PERS/TRS Board:**
 - State +\$39,433,486
 - Schools +\$35,789,260
 - UA +\$ 8,800,000
 - Municipalities/Hospitals +\$19,213,000
- **Approximate Cost to Pay PERS/TRS for FY 06 and 07 for Municipalities:**
 - FY 06 - \$21 million
 - FY 07 - \$43 million (cumulative 2 year cost)
 - State Funding needed for Total FY 06/07 for municipalities = \$64 million

(Information from: 3/04 State PERS/TRS Actuarial Study)

Public Employees' Retirement System (PERS) Municipalities & Hospitals Only

ESTIMATED FY 05 Change in Employer Contribution

* From Division of Retirement and Benefits

** Based on "2003 Alaska Taxable" DCED

| Fund | Employer | <<<PERS>>> 5.0% (D) | | | * FY 05 PERS Increase Dollars | **Value of 1 "Mill" of Property Tax | **FY 05 Local Prop Tax Mill Rate Needed for PERS Increase! |
|------|---------------------------------|--|-----------------------|--------------------------------------|--|--|--|
| | | FY 05 Estimated Municipal Payroll | FY 05 Rate Incr | FY 05 PERS Increase Dollars | | | |
| PERS | PETERSBURG, CITY& MEDICAL CTR. | \$6,702,627 | 5.0% | \$335,131 | \$191,012 | 1.75 | |
| PERS | CORDOVA, CITY & MEDICAL CENTER | \$4,427,981 | 5.0% | \$221,400 | \$111,769 | 1.98 | |
| PERS | SAXMAN, CITY OF | \$415,247 | 5.0% | \$20,762 | \$12,100 | 1.72 | |
| PERS | UNALASKA, CITY OF | \$9,508,993 | 5.0% | \$475,450 | \$342,385 | 1.39 | |
| PERS | NENANA, CITY OF | \$373,857 | 5.0% | \$18,693 | \$14,705 | 1.27 | |
| PERS | CRAIG, CITY OF | \$1,821,035 | 5.0% | \$91,052 | \$72,297 | 1.26 | |
| PERS | SITKA, CITY/BOROUGH, & HOSPITAL | \$11,507,548 | 5.0% | \$792,470 | \$639,629 | 1.24 | |
| PERS | WRANGELL, CITY OF | \$2,426,833 | 5.0% | \$121,342 | \$100,285 | 1.21 | |
| PERS | WHITTIER, CITY OF | \$944,422 | 5.0% | \$47,221 | \$39,389 | 1.20 | |
| PERS | NOME, CITY & UTILITIES | \$2,496,407 | 5.0% | \$173,791 | \$173,516 | 1.00 | |
| PERS | SEWARD, CITY OF | \$3,720,505 | 5.0% | \$186,025 | \$200,255 | 0.93 | |
| PERS | DILLINGHAM, CITY OF | \$2,355,455 | 5.0% | \$117,773 | \$130,552 | 0.90 | |
| PERS | JUNEAU, CITY AND BOROUGH OF | \$43,232,840 | 5.0% | \$2,161,642 | \$2,640,000 | 0.82 | |
| PERS | KETCHIKAN, CITY OF | \$8,020,487 | 5.0% | \$401,024 | \$547,376 | 0.73 | |
| PERS | PELICAN, CITY OF | \$126,474 | 5.0% | \$6,324 | \$8,632 | 0.73 | |
| PERS | KENAI, CITY OF | \$5,369,573 | 5.0% | \$268,479 | \$366,726 | 0.73 | |
| PERS | KODIAK, CITY OF | \$5,663,400 | 5.0% | \$283,170 | \$388,182 | 0.73 | |
| PERS | HOMER, CITY OF | \$4,738,657 | 5.0% | \$236,933 | \$332,626 | 0.71 | |
| PERS | PALMER, CITY OF | \$2,563,992 | 5.0% | \$128,200 | \$189,946 | 0.67 | |
| PERS | HAINES BOROUGH | \$2,037,530 | 5.0% | \$101,877 | \$175,187 | 0.58 | |
| PERS | BRISTOL BAY BOROUGH | \$1,368,016 | 5.0% | \$68,401 | \$141,500 | 0.48 | |
| PERS | SOLDOTNA, CITY OF | \$2,689,459 | 5.0% | \$134,473 | \$298,700 | 0.45 | |
| PERS | NORTH POLE, CITY OF | \$2,073,587 | 5.0% | \$103,679 | \$259,625 | 0.40 | |
| PERS | WASILLA, CITY OF | \$3,347,381 | 5.0% | \$167,369 | \$437,138 | 0.38 | |
| PERS | SKAGWAY, CITY OF | \$1,398,477 | 5.0% | \$69,924 | \$205,046 | 0.34 | |
| PERS | ANCHORAGE, MUNICIPALITY OF | \$127,572,934 | 5.0% | \$6,378,647 | \$19,126,104 | 0.33 | |
| PERS | SELDOVIA, CITY OF | \$96,359 | 5.0% | \$4,818 | \$19,007 | 0.25 | |
| PERS | VALDEZ, CITY OF | \$4,929,091 | 5.0% | \$246,455 | \$1,049,202 | 0.23 | |
| PERS | FAIRBANKS, CITY OF | \$5,896,416 | 5.0% | \$294,821 | \$1,321,750 | 0.22 | |
| PERS | NORTH SLOPE BOROUGH | \$47,405,369 | 5.0% | \$2,370,268 | \$10,714,796 | 0.22 | |
| PERS | KETCHIKAN GATEWAY BOROUGH | \$3,978,212 | 5.0% | \$198,911 | \$935,122 | 0.21 | |
| PERS | FAIRBANKS NORTH STAR BOROUGH | \$16,735,548 | 5.0% | \$836,777 | \$4,452,200 | 0.19 | |
| PERS | SAXMAN SEAPORT | \$38,479 | 5.0% | \$1,924 | \$12,100 | 0.16 | |
| PERS | KODIAK ISLAND BOROUGH | \$2,191,832 | 5.0% | \$109,592 | \$770,982 | 0.14 | |
| PERS | KENAI PENINSULA BOROUGH | \$12,062,817 | 5.0% | \$603,141 | \$4,277,332 | 0.14 | |
| PERS | MATANUSKA-SUSITNA BOROUGH | \$9,566,280 | 5.0% | \$478,314 | \$3,612,276 | 0.13 | |
| PERS | KACHEMAK, CITY OF | \$59,167 | 5.0% | \$2,958 | \$28,614 | 0.10 | |
| PERS | ALLAKAKET, CITY OF | \$49,434 | 5.0% | \$2,472 | none | | |
| PERS | BARROW, CITY OF | \$1,036,873 | 5.0% | \$51,844 | none | | |

| Fund | Employer | FY 05 Estimated Municipal Payroll | FY 05 Rate Incr | * FY 05 PERS Increase Dollars | ** Value of 1 "Mill" Property Tax | **Local Prop Tax Mill Rate Needed for PERS Increase! |
|-------|------------------------------|--|-----------------------|--|--|---|
| PERS | DELTA JUNCTION, CITY OF | \$65,919 | 5.0% | \$3,296 | none | |
| PERS | HUSLIA, CITY OF | \$92,276 | 5.0% | \$4,614 | none | |
| PERS | KALTAG, CITY OF | \$28,529 | 5.0% | \$1,426 | none | |
| PERS | NORTHWEST ARCTIC BOROUGH | \$700,747 | 5.0% | \$35,037 | none | |
| PERS | RUBY, CITY OF | \$118,657 | 5.0% | \$5,933 | none | |
| PERS | SAINT GEORGE, CITY OF | \$366,136 | 5.0% | \$18,307 | none | |
| PERS | AKUTAN, CITY OF | \$287,937 | 5.0% | \$14,397 | sales tax only | |
| PERS | ALEUTIANS EAST BOROUGH | \$974,507 | 5.0% | \$48,725 | sales tax only | |
| PERS | ANDERSON, CITY OF | \$38,730 | 5.0% | \$1,936 | sales tax only | |
| PERS | ANGOON, CITY OF | \$307,662 | 5.0% | \$15,383 | sales tax only | |
| PERS | ATKA, CITY OF | \$71,502 | 5.0% | \$3,575 | sales tax only | |
| PERS | BETHEL, CITY OF | \$4,537,734 | 5.0% | \$226,887 | sales tax only | |
| PERS | DENALI BOROUGH | \$568,543 | 5.0% | \$28,427 | sales tax only | |
| PERS | EGEGIK, CITY OF | \$97,862 | 5.0% | \$4,893 | sales tax only | |
| PERS | ELIM, CITY OF | \$175,041 | 5.0% | \$8,752 | sales tax only | |
| PERS | FORT YUKON, CITY OF | \$295,768 | 5.0% | \$14,788 | sales tax only | |
| PERS | GALENA, CITY OF | \$1,320,610 | 5.0% | \$66,031 | sales tax only | |
| PERS | HOONAH, CITY OF | \$638,162 | 5.0% | \$31,908 | sales tax only | |
| PERS | HOOPER BAY, CITY OF | \$592,669 | 5.0% | \$29,633 | sales tax only | |
| PERS | KAKE, CITY OF | \$291,898 | 5.0% | \$14,595 | sales tax only | |
| PERS | KING COVE, CITY OF | \$1,035,132 | 5.0% | \$51,757 | sales tax only | |
| PERS | KLAWOCK, CITY OF | \$820,343 | 5.0% | \$41,017 | sales tax only | |
| PERS | KOTZEBUE, CITY OF | \$3,138,622 | 5.0% | \$156,931 | sales tax only | |
| PERS | KOYUK, CITY OF | \$21,463 | 5.0% | \$1,073 | sales tax only | |
| PERS | LAKE AND PENINSULA BOROUGH | \$632,700 | 5.0% | \$31,635 | sales tax only | |
| PERS | NOORVIK, CITY OF | \$351,910 | 5.0% | \$17,595 | sales tax only | |
| PERS | QUINHAGAK, CITY OF | \$29,932 | 5.0% | \$1,497 | sales tax only | |
| PERS | SAINT MARY'S, CITY OF | \$306,495 | 5.0% | \$15,325 | sales tax only | |
| PERS | SAINT PAUL, CITY OF | \$1,366,801 | 5.0% | \$68,340 | sales tax only | |
| PERS | SAND POINT, CITY OF | \$758,056 | 5.0% | \$37,903 | sales tax only | |
| PERS | SELAWICK, CITY OF | \$77,442 | 5.0% | \$3,872 | sales tax only | |
| PERS | TANANA, CITY OF | \$217,611 | 5.0% | \$10,881 | sales tax only | |
| PERS | THORNE BAY, CITY OF | \$279,855 | 5.0% | \$13,993 | sales tax only | |
| PERS | TOKSOOK BAY, CITY OF | \$16,994 | 5.0% | \$850 | sales tax only | |
| PERS | UNALAKLEET, CITY OF | \$264,140 | 5.0% | \$13,207 | sales tax only | |
| PERS | YAKUTAT, CITY AND BOROUGH OF | \$439,129 | 5.0% | \$21,956 | sales tax only | |
| PERS | ANCHORAGE PARKING AUTHORITY | \$1,020,063 | 5.0% | \$51,003 | see Anch | |
| TOTAL | | | | \$19,430,923 | | |

Testimony by Sam Harbo
UAF Retired Professor of Bio-Statistics

Longevity figures are estimates based on selected groups of individuals. Such estimates usually work well when used with projections associated with groups, such as the actuarial projections for the group of retirees in the DB plan. Individual retiree variations in such a plan (e.g. one retiree dying at an early age and another at an older age) tend to compensate for one another, with the actuarial projections accommodating continued pension payments to the long-lived retiree. Such is not the case in a DC plan. Everything there depends on an individual's history, not on group dynamics. Using group-based projections to evaluate a DC plan can hide a world of hurt.

For example, suppose the life expectancy is estimated to be 80 for the average retiree, with the amount of money (plus earnings) in a retiree's DC pension fund projected to last to year 80. Let us assume that all the underlying assumptions governing the above are objective and reasonable. Even if the above DC monthly pension payment is greater than what the retiree would have gotten under our current DB Tier 1 plan, one should not conclude immediately that the DC plan is better. At the very least, one should determine what proportion of retirees live to age 80, and what their life expectancy is at that age. Is it 6, 8, or 10 more years with no pension payment?

Another major difficulty with comparing DC and DB plans is that not all employees retire at the same age. That confuses the longevity picture (and any resulting projections) because an employee retiring at age 55 has a different projected mortality age than does an employee retiring at age 65. That is, life expectancy is retirement age specific. That difficulty is manageable in a DB plan because group dynamics are involved.

Unfortunately, group dynamics do not govern the fortunes of individual retirees in a DC plan; each individual's retirement age is paramount there.

I am not asserting that group projections are not useful in gaining insight into DC plans. In fact I have done just that myself. However, such projections must be evaluated and used with care. One must emphasize the individual in a DC plan.



To: Senator Lyda Green, Chair, Senate Finance
From: Gayle Harbo, Teacher Retirement System Bd.
Re: Senator Stedman's Comments, Mar. 30 am, SFC

Senator Stedman, during his presentation on proposed Board reconfiguration, made a comment to which I take exception. Had I been allowed to give my testimony that day I would have responded in person, but realize the Committee had limited time that morning.

Senator Stedman, speaking in regard to the 3 retirement boards, said, "we've had them all in here and all there's been is finger pointing." I have never observed members of any of the three boards finger pointing. The Boards, in fact, requested an actuarial audit several years ago because they questioned some of the information they were receiving from Mercer. Milliman, the auditors, found several gross errors, particularly with respect for medical expense accounting. (see Sept. Joint Board minutes, page 6).

As I stated in my testimony on March 29, the three boards work well together and I have great respect for the members of ASPIB, the work they do and the staff which supports them. I don't know who Senator Stedman is referring to when he says "we've had them all in" - Mar. 29 is the first time in my 6 years on the TRS Board that I have testified and to my knowledge since SB141 came out no one on the three boards had testified before any committee. If he has names then tell us, but please do not make accusations.

Senator Stedman talks about professionalism on the Boards. The members we have now and have had are well respected members in their communities and give countless hours preparing for appeals and for other meetings, all on their own time. The Boards have always asked good questions and sought information from the actuary and Administration to make sound decisions.

I was dismayed at our last joint meeting that many of the Board members did not even receive the actuary's valuation until the day of the meeting. New information on how to calculate and project medical costs was contained in the valuation. For the first time health and prescription costs were separated and presented on cost per member basis, something I asked the actuaries for years ago. It makes it much easier to compare costs from year to year at a glance. Not only did we get new material, the Division had put a presentation on LTC on the agenda, which could have been held at a later time or scheduled for Fri., Mar. 25. These Boards are dedicated to serving members interests, another reason to have member representation. Employers are members of the system. They too may be represented.

Thank for allowing me to testify on the 29th and I know my written testimony for the 30th is in the record.

Respectfully

Gayle Harbo

Retired Teacher
TRS Trustee



NEA-ALASKA

Affiliated with the National Education Association

TRS/PERS Issues for Testimony

Senator Green and members of the Senate Finance Committee, for the record my name is Bill Bjork. I am presently serving as the President of NEA-Alaska. As we examine the retirement issues it is important to remember the purpose of the retirement system (Sec. 14.25.012) which "is to encourage qualified teachers to enter and remain in service with participating employers." Although there is some anecdotal evidence that the retirement benefits can be used for recruitment, its main attraction is a tool for retaining educators. Job satisfaction, competitive compensation and retirement benefits are the three major reasons for a person to remain in education.

When people consider their retirement benefits, they want to be able to retire with dignity and to maintain that dignity through their retirement years. What does that mean? For most educators it means to maintain a standard of living that is middle class. Under the present system teachers retire with an income of 50%-60% of their salary with health insurance provided. This takes 27 years of service to earn.

The present system is based on several actuarial assumptions. There is still debate about the correctness of these assumptions. Before we can actually determine if a person can retire with dignity, we must know the assumptions.

Thus, in order to establish a new and improved system, NEA-Alaska believes we should adopt ASSUMPTION #1: An educator with 27 years of service should be able to receive an annual annuity of at least 55% of their salary at retirement. Today the teacher average salary is \$51,062. To have an annual annuity that is a middle class standard of living, the educator would receive approximately \$34,000 or two-thirds of the TAS. Under HB 238 a person needs to work for at least 30 years. If you corrected one of the flaws in the present system and used an average of the employee's salaries over their career instead of the average of the high three years, the person would need to earn 2.25% per year to produce a middle class standard of living in retirement.

How much a retired person receives as an annuity is dependent upon the investment return and the amount of contributions made during each year of active service. ASSUMPTION #2: The investment return must be at least 8.25% per year, compounded annually, net of expenses. *This is the same assumption that is presently in place. It is also consistent with the Permanent Fund assumptions.* ASSUMPTION #3: The combined contribution of the employee and the employer to the pension must be at least 20%. *Looking at defined contribution plans in the private sector, this is an appropriate level.* ASSUMPTION #4: Inflation will increase by 3% annually. *The present assumption is 3.5% annually. This is not consistent with the Permanent Fund assumptions.* Given that inflation has been 2.6% over any ten-year period in Alaska, why would we adopt a 3.5% inflation rate? How much does a .5% over twenty-five years add to the Past Service Cost?

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FAIRBANKS REGIONAL OFFICE • 2118 S. Cushman Street • Fairbanks, Alaska 99701 • (907) 456-4435 • FAX: (907) 456-2159

Assumptions are critical in determining the necessity of a new and improved retirement plan. Making the wrong assumptions today will only lead to retirees having no dignity and becoming dependent upon the state of Alaska for welfare. **We must take the time to reach an agreement on the actuarial assumptions to be used.**

NEA-Alaska understands the deep concerns surrounding the issue of the Unfunded Liability of the Teachers' Retirement System and the Public Employees' Retirement System. The causes and the amount of the Unfunded Liability or the Past Service Cost are a part of the debate; however, I believe there is agreement that the actuarial assumptions made in the past have brought us to this point. The projected cost of health care, the delayed use of mortality rates and the addition of benefits without an increase in contributions are three of the major factors.

At least two of those factors can be corrected without the adoption of a new tier for TRS and PERS. The use of the most recent mortality tables could be mandated by the legislature. The legislature could also require an actuarial valuation of any proposed benefit increase and require an increased contribution rate to cover Past Service Cost at the time of passage. For example, if the retired, rehired legislation is recommended for passage, the legislature should set a contribution rate for that benefit, which would be paid by the governmental entity that takes advantage of the legislation.

NEA-Alaska also believes that health care costs can be managed to provide a more predictable rate increase. It seems that the Health Cost Trend actuarial assumptions provided to the Administration on June 30, 2002 defied common sense and logic. The projections were:

| | |
|--------------|----------------------|
| FY 01 – 7.5% | FY 04-08 – 5.0% |
| FY 02 – 6.5% | FY 09-FY 13 – 4.5% |
| FY 03 – 5.5% | FY 14 & later – 4.0% |

Anyone using health care services could tell you those rate projections were not based in reality. In fact the next year the assumptions were changed to be:

| | |
|---------------|------------------------|
| FY 04 – 12.0% | FY 11 – 9.0% |
| FY 05 – 12.0% | FY 12 – 8.5% |
| FY 06 – 11.5% | FY 13 – 8.0% |
| FY 07 – 11.0% | FY 14 – 7.5% |
| FY 08 – 10.5% | FY 15 – 7.0% |
| FY 09 – 10.0% | FY 16 – 6.0% |
| FY 10 – 9.5% | FY 17 and later – 5.0% |

These numbers make a pretty, downhill slope, but are they based in any reality? How could such a drastic change occur in one year? This kind of dramatic change does not inspire credibility in the actuary. Is this the kind of assumption that the \$5 billion Unfunded Liability is based upon?

For the record, teachers that begin their careers at the age of 22 and work for 30 years without interruption will be 52 when they can retire. That is 3 more years than the present average years of service. Since they cannot receive medical benefits until age 65, they would actually have to teach 43 years or pay for their health care for 13 years, which would erode their pension annuity

significantly. Again, the actual affect can only be determined once the actuarial assumptions are finalized.

NEA-Alaska believes that several things could be done to provide a new and improved retirement system for both teachers and public employees. The key is what assumptions are put in place. NEA-Alaska stands ready to work with the committee to determine the appropriate actuarial assumptions upon which to build a new and improved retirement system that inects the purpose of recruiting and retaining qualified educators and public employees.



KENAI PENINSULA BOROUGH SCHOOL DISTRICT

Finance

Melody Douglas, Chief Financial Officer
148 Binkley Street Soldotna, Alaska 99669-7553
Phone (907) 262-5846 Fax (907) 262-9645

Draft

Testimony before the Alaska Legislature
Public Employee's Retirement System
Teacher's Retirement System
April 6, 2005

Thank you for the opportunity to speak on this important matter. My name is Melody Douglas and I am the chief financial officer for the Kenai Peninsula Borough School District. The District is the largest employer on the Kenai Peninsula and the 4th largest District in the State, employing approximately 1100 people.

You are going in the right direction with much of the legislation contained in SB141 for PERS and TRS employees and elected officials. Thank you for your hard work. I would like to bring a few issues to your attention today for further discussion and resolution.

Creating a new tier for both PERS and TRS is essential to the health of these systems. However, a significant issue in my mind is the unfunded liability of the nearly \$6 billion if paid today, most of which is coming from full health benefits for retirees younger than 65. I ask that pension bonds be explored to address this matter. I have heard it said that we (the state) can't commit those coming after us by such a financing arrangement. The fact is that the financial commitment is already here; we are just paying for it with increased employer contribution rates. It's not only prudent; it is our responsibility to address this matter. Pension bonds, for even a portion of the unfunded liability if not all, would have the affect of lowering employer contribution rates. Estimated bond rates of 5.5 to 6% would generate a savings as compared to the 8.25% currently charged to employers for the PERS and TRS unfunded liability. However, the benefit of this option will decline as interest rates rise.

New tiers should be based on a defined contribution retirement system for new employees. Corporate America has transitioned to a defined contribution system because they could no longer afford to incur all the risk of a defined benefit retirement system. The Public Sector must follow suit; the Kenai Peninsula Borough School District does not have the funds to address ongoing employer rate increases without draconian cuts in the classroom. I am concerned about attracting and retaining quality employees throughout the State. I don't see a defined contribution system and recruiting and retention as mutually exclusive if the system includes a combination of say 50% fixed (less risky) investing, and 50% flexible investing, in conjunction with a health care

ANCHOR POINT COOPER LANDING HOMER HOPE KACHEMAK SELO KENAI MOOSE PASS NANWALEK NIKISKI NIKOLAIIVSK NINILCHIK
PORT GRAHAM RAZDOVNA SILDONIA SEWARD SOLDOTNA STEPLING TUSTUMENA TYONIK VOZNESENKA

4/6/05

benefits. Requiring a fixed investment component will ensure a secure level of retirement benefits for individuals. Portability of an individual's retirement fund is an attractive feature of a defined contribution system, given that younger generations are expected to change jobs 7 or more times during their career.

The PERS and TRS Boards should include employer representation in their make-up. Since employers pay the lion share of the contribution rates to fund these systems, they should have a voice in the deliberations of these boards. It is prudent to evaluate the validity of what is done on a regular basis; consolidation of these boards and evaluation of their responsibilities and possible reassignment of some tasks is timely.

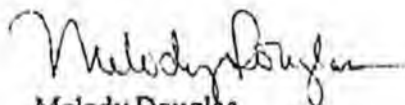
Future benefit changes, such as increasing health benefits for certain classes of employees, should be thoroughly reviewed for long-term financial impact before implemented. The lack of an adequate analysis process contributed significantly to the unfunded liability. Please establish a 90 day review process, supported by a comprehensive long-term actuarial analysis, a public hearing process and a recommendation of the retirement boards prior to any legislative changes affecting PERS and TRS. We need to ensure that these systems don't continue to decline financially.

I recommend that actuarial services include a peer review component on a periodic basis and/or a new actuary be hired after a certain number of years. No matter that the concept of hindsight is significantly at play in this situation, common sense doesn't allow for decreased employer rates in a time when increased health care costs and declining or negative investment returns were being realized by nearly all entities nationally. Relying on the scheduled review timeline contained in the contract, to thoroughly actuarially evaluate these systems, in such times is unacceptable.

It is unlikely that any legislative decision made this year can be fully implemented by July 1. Please fund the 5% PERS and TRS employer rate increases in effect for FY06 for all employers statewide. This rate increase equates to approximately \$2 million for the Kenai Peninsula Borough School District for FY06. The Board of Education approved the FY06 budget, which includes Governor Murkowski's proposed base student allocation of \$4880, Monday night. The District will likely have to reduce this budget if additional funds are realized to address the retirement rate increases. To put \$2 million into perspective for the District, it would equate to approximately 35 teaching positions.

Thank you for your continued work on this critical issue fac
appreciate the opportunity to bring these important issues to

State of Alaska. I
ention.


Melody Douglas

Public Employees' Retirement Board

Alaska Division
Retirement and Benefits

Meeting Schedule

ASPIB

e-mail



George Sullivan, Chair
Term Expires 6/20/06 (Appointed)

George Sullivan grew up in Alaska. After graduation from Valdez High School he joined the Army during WWII and served in the Aleutians. George represented the Anchorage area in the legislature in the mid 60's and was mayor of Anchorage from 1967 to 1982. He has always been active in the community and continues to provide leadership to a number of organizations in Alaska, including The Anchorage Center, Boys and Girls Club, Enstar Gas Board, Pioneers of Alaska, and the Foreign Wars. George lives in Anchorage with his wife, Margaret. They divide their retirement days between a very appreciative community and the families of their children, which include 15 grandchildren and 1 great-grandchild.



Alyce Hanley, Vice Chair
Term Expires 06/20/08 (Appointed)

Alyce Hanley has lived in Anchorage since 1971. She graduated from high school in Pawtucket, Rhode Island and completed her nurse's training at the New England Deaconess Hospital School of Nursing in Boston, Mass. She was elected to the Anchorage School Board in 1981 and to the Alaska House of Representatives in 1983. After serving three terms, she chose not to run for re-election. In 1993, Mrs. Hanley was appointed to serve as a Commissioner with the Alaska Public Utilities Commission. She retired from that position in April 1999.

Alyce enjoys family activities with her five sons, their wives and seven grandchildren, all of whom live in the Anchorage area.



Frank Narusch
Term Expires 04/24/06 (Elected)

Frank Narusch has been an Alaskan resident since 1952. Raised in the coal town of Suntrana on the Healy River, he boarded away to attend high school at Noyes School in Fairbanks and Copper Valley School in Glennallen. While attending Fairbanks University, he worked summers commercial fishing in Cordova, coal mining in Suntrana, and surveying and inspecting projects around Fairbanks and Valdez for the Department of Highways. After receiving a degree in civil engineering in 1968, he began his professional career with the Department of Highways (now DOT&PF). During 17 years of State employment, he held positions as Construction Project Manager, Materials Engineer, Contract Claims Engineer, and Professional Services Coordinator. Upon retiring from DOT&PF in 1997, he was active with the Alaska Public Employees Association as an employee representative, local officer, and state director.

Upon retiring from DOT&PF in 1997, Frank organized the Retired Public Employees of Alaska and currently serves as Membership Chairman and Newsletter Editor. He attends weekly breakfast get-togethers with retired friends as well as summer travel and exploring back roads around the State.



James "Pat" Wellington
Term Expires 04/05/08 (Elected)

Pat Wellington was born in Ketchikan, Alaska and graduated from Douglas. He served two years in the U.S. Army and started his law enforcement career with the Seward Police Department in late 1955. He served as Deputy U.S. Marshal, Troopers; Chief of Police of Juneau; Deputy Commissioner and Commissioner of the Department of Public Safety; and retired in 1977 as Director of the Alaska Troopers. Mr. Wellington is also a trustee of the Alaska State Pension Invest



Bronk Jorgensen
Term Expires 06/20/10 (Appointed)

Bronk Jorgensen was born in Jackson Hole, Wyoming. He became an Alaskan in 1978, before he was one year old. Bronk attended Tok School, the University of Alaska Fairbanks and attended the University of Pittsburgh, Semester at Sea, graduating with a degree in Business Administration.

Bronk lives in Tok and is the owner/manager of All Alaska Gifts and Crafts and Jorgensen Realty. He is also a member of the Tok and State of Alaska Chamber of Commerce and was the 2002 recipient of the Chuck West New Pioneer Award from the Alaska Travel Industry Association.

Bronk enjoys Alaska's hunting, fishing and outdoor activities.

6th Floor, State Office Building
PO Box 110203, Juneau, AK 99811-0203, Phone: (907) 465-446
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Since 8/14/2001

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Teachers' Retirement Board

Alaska Divi
Retirement and B

Meeting Schedule

ASPIB

e-mail



Gayle W. Harbo, Chair

Term Expires 6/30/05 (Appointed)

Ms. Harbo was appointed to the Teachers' Retirement Board in 1999. G. Alaska in 1957, married Sam Harbo in 1958, and lived in Cold Bay, Jun before settling in Fairbanks in 1962. She graduated from North Carolina Raleigh with a BS in Mathematics and earned a Master of Arts in Teach University of Alaska-Fairbanks. She taught at Lathrop High School for five years in the Fairbanks District and served as coordinator of the scho Placement Program and on the District's Curriculum Committee. She wo committees which wrote the evaluation documents used by the district a several budget committees. Since retiring in 1993, she has enjoyed trave husband and assisting him with several building projects for each of thei loves her home and garden and the opportunity to take care of any or all grandchildren.



Richard J. Solie Sr., Vice Chair

Term Expires 01/31/07 (Appointed)

Richard Solie has been an Alaska resident for 33 years. He received his from the University of Wisconsin, Superior, and his Ph.D. degree in Eec University of Tennessee. After seven years of teaching in the "Lower 48 Professor of Economics, Head of the Department of Economics, and Ae School of Management at the University of Alaska, Fairbanks during the 1986. Following his retirement from UAF, he was self-employed in his consulting firm. He and his wife, Elsie, live in Fairbanks along with thei ten grandchildren.

Kerry Jarrell

Term Expires 01/31/08 (Appointed)

Bio and picture will be posted when available.

Dick Shultz

Term Expires 01/31/06 (Appointed)

Dick Shultz moved to Alaska in 1970 from Anselmo, a small town in ce settled in Mentasta Lake, a remote native village southwest of Tok wher kindergarten through the eighth grade. Dick relocated to Northway and 1 years after which his career took him to Delta Greely as a school guidan 1978, Dick returned to rural teaching in Nabesna until 1980, when he ret



Greely school district as the assistant superintendent.

Dick left his career in education in 1982 when he was elected to the House of Representatives for District 17. He served in the legislature for ten years as a representative and two as a senator until he retired from public service in 1992. He and his wife live in a rustic setting near Tok, where he enjoys life as an avid outdoorsman.

Dick was appointed to serve on the Teachers' Retirement Board by Governor W. W. Miller and he is looking forward to serving. He says, "I have always been concerned about maintaining the integrity of the fund to insure future retirees that their system will provide stable retirement benefits."

Vacant

Term Expires 06/30/05 (Appointed)

6th Floor, State Office Building
PO Box 110203, Juneau, AK 99811-0203, Phone: (907) 465-4460, Fax: (907) 465-3080
[\[department of administration - state - state employees - contact us - office locations \]](#)

Since 8/14/2001

002020

Received
25 April 2005

Introduced by: Mayor Selby
Requested by: Mayor Selby
Introduced: 04/07/2005
Adopted: 04/07/2005

KODIAK ISLAND BOROUGH
RESOLUTION NO. FY2005-23

A RESOLUTION OF THE KODIAK ISLAND BOROUGH ASSEMBLY URGING
THE ALASKA STATE HOUSE AND SENATE TO APPROVE THE GOVERNOR'S
PROPOSED \$37.5 MILLION APPROPRIATION TO OFFSET THE COST OF
STATE REQUIRED MUNICIPAL PERS INCREASES FOR THE NEXT TWO YEARS

WHEREAS, the State has notified the Kodiak Island Borough that its' PERS rate will increase from 5% in FY2005 to 10% in FY2006, and will continue to increase until it reaches a total rate of 28.34%; and

WHEREAS, PERS is a single employer retirement system and the Kodiak Island Borough has an unfunded liability of \$4,119,487, not shared with other PERS employers; and

WHEREAS, mandatory State PERS increases on top of the loss of municipal revenue sharing as well as fuel, insurance and other cost increases leave many municipalities without the resources to fully fund schools, police, or other basic services; and

WHEREAS, the Kodiak Island Borough would have to raise its' mill levy close to 1 mill to fully fund its' state mandated PERS costs but has a tax cap that precludes such increases and will require the Borough to make deeper cuts to local basic services; and

WHEREAS, the Alaska Municipal League and many municipal elected officials and finance directors have been "at the table" to help the State adopt a new PERS/TRS "tier" to help control future costs; and

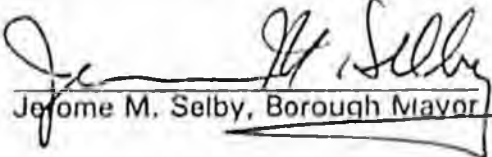
WHEREAS, the State has received a huge increase in oil revenue while communities are facing steeply higher expenses. For every \$1 increase in the price of a barrel of oil the State government receives an additional \$65 million of new revenue per year while Alaskan cities, boroughs, schools, businesses, other organizations, and families pay \$20 million of higher new costs for fuel, transportation, etc based on federal fuel usage figures for Alaska; and

WHEREAS, if the State fails to share a small portion of its huge oil revenue increases with our community/local taxpayers to offset State required PERS payment increases for at least the next two years, the impact on Kodiak Island Borough will be higher taxes plus a reduction in the ability to pay for education, planning and zoning, health, and other basic Borough functions.

NOW, THEREFORE, BE IT RESOLVED BY THE ASSEMBLY OF THE KODIAK ISLAND BOROUGH that the members of the Alaska State House and Senate are strongly urged to approve the Governor's proposed \$37.5 million appropriation to offset the cost of State required municipal PERS increases for the next two years. This action will avoid large local tax increases and/or large cuts to local services including schools, maintenance of Borough buildings and other improvements, planning and zoning, equity in Borough property assessments, and other services.

ADOPTED BY THE ASSEMBLY OF THE KODIAK ISLAND BOROUGH
THIS SEVENTH DAY OF APRIL 2005

KODIAK ISLAND BOROUGH


Jerome M. Selby, Borough Mayor

ATTEST:


Judith A. Nielsen, CMC, Borough Clerk

SB

141

FREE

CONF.

COMM.

SFIN

FILE

Received in the Senate: _____
(Date/Time)

Received in the House: _____
(Date/Time)

CONFERENCE COMMITTEE REPORT

Date: 13 May 2005
(Reported out of committee)

MR. PRESIDENT: MR. SPEAKER:

The FREE CONFERENCE COMMITTEE considering:

•Senate Version:

CS FOR SENATE BILL NO. 141(FIN)

An Act relating to the teachers' and public employees' retirement systems and creating defined contribution and health reimbursement plans for members of the teachers' retirement system and the public employees' retirement system who are first hired after July 1, 2005; relating to university retirement programs; establishing the Alaska Retirement Management Board to replace the Alaska State Pension Investment Board, the Alaska Teachers' Retirement Board, and the Public Employees' Retirement Board; adding appeals of the decisions of the administrator of the teachers' and public employees' retirement systems to the jurisdiction of the office of administrative hearings; providing for nonvested members of the teachers' retirement system defined benefit plans to transfer into the teachers' retirement system defined contribution plan and for nonvested members of the public employees' retirement system defined benefit plans to transfer into the public employees' retirement system defined contribution plan; providing for political subdivisions and public organizations to request to participate in the public employees' defined contribution retirement plan; and providing for an effective date.

and

•House Version:

HOUSE CS FOR CS FOR SENATE BILL NO. 141(FIN) am H
(Same Title)

Recommends the:

FCCS for Senate Bill 141 be adopted.

New Title (tech. - see attached) Same Title as: Senate Version House Version

- or - Recommends the: Senate Version House Version **be adopted.**

_____ Letter of Intent attached.

| FN # | List by Dept(s) | New Fiscal Note | Previous Fiscal Note | Fiscal Impact | Indct. | Zero |
|------|-----------------|-----------------|----------------------|---------------|--------|------|
| 1 | Admin | | X | X | | |
| 3-7 | Revenue | | X | X | | |
| 9 | Admin | | X | X | | |
| 11 | Admin | | X | X | | |
| | | | | | | |
| | | | | | | |

Senate Conferrees:

[Signature]
Senator Stedman, Chair

[Signature]
Senator Wilken

[Signature]
Senator Elton

House Conferrees:

[Signature]
Representative Kelly

[Signature]
Representative Hawker

[Signature]
Representative Kerttula

Return Conference Bill and attachments to the Senate Secretary's Office.

Received in the Senate: _____
(Date/Time)

Received in the House: _____
(Date/Time)

CONFERENCE COMMITTEE REPORT

Date: 13 May 2005
(Reported out of committee)

MR. PRESIDENT: MR. SPEAKER:

The FREE CONFERENCE COMMITTEE considering:

•Senate Version:

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and

•House Version:

HOUSE CS FOR CS FOR SENATE BILL NO. 141(FIN) am H
(Same Title)

Recommends the:

FCCS for Senate Bill 141 be adopted.

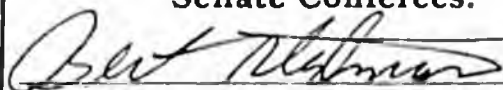
New Title (tech. - see attached) Same Title as: Senate Version House Version

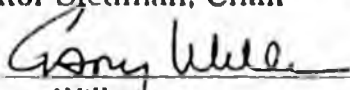
-- or -- Recommends the: Senate Version House Version **be adopted.**

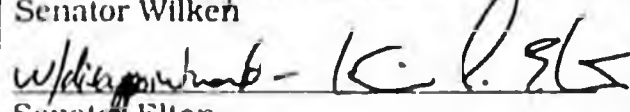
_____ Letter of Intent attached.

| FN # | List by Dept(s) | New Fiscal Note | Previous Fiscal Note | Fiscal Impact | Indet. | Zero |
|------|-----------------|-----------------|----------------------|---------------|--------|------|
| 1 | Admin | | X | X | | |
| 37 | Revenue | | X | X | | |
| 9 | Admin | | X | X | | |
| 11 | Admin | | X | X | | |
| | | | | | | |
| | | | | | | |

Senate Conferees:


Senator Stedman, Chair


Senator Wilken


Senator Elton

House Conferees:


Representative Kelly


Representative Hawker


Representative Kerttula

Return Conference Bill and attachments to the Senate Secretary's Office.