

ALASKA LEGISLATURE SPECIAL COMMITTEE/SUBJECT FILES 8672

3083 SCOMM 142: HOUSE SPECIAL COMMITTEE ON WAYS & MEANS 2005-2006

TESTIMONY by Gayle Harbo
TRS Trustee
House State Affairs and Senate Finance *April 6, 2005*

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...

Gary Wilken

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, GPOWEP, 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.

April 6, Senate Finance

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.

*Re. Boards
Composition*

Testimony SB 141

Gayle Harbo, April 2005 - *Sent Apr 15 - For delegation*

The current system of 3 pension boards may, at first, seem cumbersome, but each has a slightly different role. The Boards work well together and the Jt Boards of TRS and PERS appreciate the time and effort of the Alaska State Pension Boards members to manage and invest the billions of dollars of pension fund assets. ASPIB's role and function was carefully crafted in the early '90's. They have done an excellent job and invested many volunteer hours.

PERS and TRS are advisory to the Administration, except for appeals, and in the case of PERS, setting the employer contribution rate.

It is important to have members of the system on any board which oversees the billions of dollars of pension fund money or listens to appeals. The boards are fiduciaries and should include members who contributed to the funds. It is also important for system members to have appeals heard and resolved by peers.

Elected representation from both TRS and PERS is a must on any board. I see no problem with merging the TRS/PERS Boards and I spoke at length with Rep Kelly's aide, Heath Hillyard, regarding the combination. A seven person board, with equal elected representation(for example 2 each as on the current PERS Board), plus one school district employer and one municipal employer and one other appointed person would be workable.

I ask you to please retain these important boards, keeping ASPIB with its current structure, and assuring there is elected representation of the parties who have contributed to the pension funds.

Gayle Harbo

Box 10201

Fairbanks 99711

Testimony of HB238/SB141
Gayle Harbo, April 2005

I have heard and read in the press that Alaska's public pension funds are in crisis. I have heard the figure "a 5 billion dollar unfunded liability". The liability is a crisis only if every PERS and TRS active member retires tomorrow and is paid all the money entitled to them for all their retired years. The funds, without health care costs, are in good shape. The earnings on the pension funds for each of the past two years have been 15%, better than the Permanent Fund. The funding ratios for non-medical benefits for TRS and PERS, based on market assets, are 93% and 120%, respectively. With medical benefits, the funding ratios drop to 64% and 74%, respectively. It doesn't take a rocket scientist to see that increasing health care costs are the problem. It is a recognized problem that can be solved without legislation. The Administration, working with employee groups, can make changes to current tier medical plans if the changes are for choice or convenience. They also have the ability to change the plan for future hires.

Have the funds been here before? You bet - in 1980, the funding ratio for TRS was 67%. At that time the contribution rate for the our model 50 year old system was roughly 7% each for employee, employer and the state, or 21% of payroll. When the state started funneling its share through the districts in FY'87, the contribution rate for the employer/state continued to decline to 12% until FY'05. The rate was then increased to 16%. Half the increase in the past few years has been caused by rising health care costs : a problem not unique to Alaska. This legislation seems to forget the state's share and speaks only to employee and employer sharing equally. No longer would 21% of payroll go to retirement.

Can the problem with health care costs be addressed? The Division of Retirement and Benefits and the Joint Boards of TRS and PERS have been working on cost containment, most recently with a generic drug campaign and in the near future with other measures such as preferred providers and closed formularies. The Division is also introducing a Positive Enrollment Program which they predict may save the state \$16 million dollars.

So you ask, why is the problem called a crisis? Some interests, both in and out of Alaska, want to privatize public pension funds. Alaska is only one of several states where some legislators have "bought in" to the need to privatize the billions of dollars of such funds. Most Alaskans know that is not the path to follow - many past legislators like Jay Hammond, Terry Miller, Arlyss Sturgelewski and Charlie Parr worked to make Alaska's 50 year old retirement system a model for other systems in the country. Alaska is one of only four states which prefunds health care. Alaskans pride themselves on being independent and not having others tell them what to do.

The Employee Security Act which passed out of the senate as SB141 is a bill which assures *no security* for future retirees. It *takes away* the Defined Benefit plan which provides for a safe and secure income for Alaska's elderly in their golden years. In its

place is a DC plan. We all know DC plans discriminate against women, simply because they live longer. It would leave future retirees with no guaranteed monthly income, no health insurance and no cost of living adjustment. Many of these same legislators who would impose this system on future retirees have experienced what it means to take care of aging parents or loved ones who suffer from terminal illness or dementia, yet those same legislators would condemn future retirees to uncertain futures. It is not right, it is not fair, it is not necessary.

Talk with an employee who has been retired for 20 years or more and ask if they could now live on their base benefit, with no COLA or prpa. Under a DC plan there will be no incentive for retirees to remain in Alaska and contribute their time, expertise and pension dollars to Alaska's communities.

Why would our state, which has received almost 100% more than its budgeted amount for oil revenue, turn its back on seniors who have dedicated their lives serving Alaska's citizens? Only a few legislators would do this. They do not have the courage of those past legislators like Jay, Terry, Arlyss and Charlie. They do not have the courage of Senator Lisa Murkowski who has always been a strong proponent of public education and parent involvement. She had the courage to sign on to the repeal of the Government Pension Offset and the Windfall Elimination Provision, two provisions which reduce or eliminate Social Security retirement for thousands of Alaska's public servants. Senator Murkowski would not want to see legislation which would further discourage qualified teachers and public employees from coming to Alaska to work and from making Alaska their home.

Please "***make Alaska proud***" - contact your legislators, the Governor and our Congressional Delegation. Tell them we do not want outsiders telling us how to run our pension funds. Our funds are in great shape if you look at the long term. As Michael O'Leary, the financial advisor for the Alaska State Pension Investment Board, recently said - "How powerful any time period is when looking at investment return". Think long term. Governor Murkowski, in his Dec. 13 2004 letter to seniors, stated "care for our elders and for vulnerable adults in our society is vital to our success as a state." He further states - "***seniors should not have to choose between paying their rent, buying food or being able to fill prescriptions.***" That is exactly what many seniors will have to do if the legislature does away with a ***Defined Benefit*** retirement system. Please ask your legislators to "***make Alaska proud***" and retain our current ***Defined Benefit*** system. We can all work together to address health care costs.

We can 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 developing a solution which works for all. There are many good things in this legislation which help close some of the loopholes, but doing away with a Defined Benefit plan is not one of them. Thanks for your time.

Gayle Harbo, Box 10201, Fairbanks 99710

April 18 2005

To: Governor Frank Murkowski
Capitol Building
Juneau, Alaska 99801 - 1182

From: Gayle Harbo
Box 10201
Fairbanks, Alaska 99710

Re: Retirement Legislation

Dear Governor Murkowski:

I know you are familiar with the myriad bills in the current legislature dealing with the retirement systems of PERS and TRS. Some legislators would make "Draconian" changes in our model, fifty year old system. These changes would give no immediate relief to employers responsible for past service costs, yet they would have a lasting, devastating affect on future hires. It has been pointed out to the legislators, over and over, that our system is quite healthy when medical costs are not considered. Alaska has always taken pride in our retirement system and the fact we are one of only four states which prefunds the medical benefits.

When the Tier Committee of the Joint Boards met, and worked for over year on a proposal to help contain costs, they presented many good ideas to close loopholes, to have a longer period of time to compute average salaries and to prevent people who are not career employees from vesting and accessing the health benefit component. They explored ways to reduce health care costs and to move the retirement age closer to the time when people would have access to Medicare, which at age 65, becomes primary to Alaska Care, our self-insured plan. No member of the Tier Committee supported a pure Defined Contribution plan, though a few supported a hybrid. Chair Bob Boko, a man of great integrity and honesty, was most upset when the Commissioner of Administration insisted that a pure DC plan be included. The Joint Boards, when presented with the final Tier Plan Nov. 19, could not support the plans presented because of the DC component. Board members had many helpful suggestions and wanted to meet again, at Mr. Boko's urging, after a meeting with ASPIB on December 1. They were not allowed to meet and to have an open, honest exchange, nor the opportunity to reach consensus on a plan to which all could agree. The Boards did not want to be "a rubber stamp". The Tier Committee worked for over a year and one day was not enough time to be presented a plan and to be expected to make a well thought out decision when they were allowed little free discussion or time to point out the good points of the plan.

Governor Murkowski, we do not need to impose a Defined Contribution plan on future hires. The Employee Security Act, passed out of the senate as SB 141 is a bill

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which assures *no security* for future retirees. It *takes away* the Defined Benefit plan which provides for a safe and secure income for Alaska's elderly in their golden years. It would leave future retirees with no guaranteed monthly income, no health insurance and no cost of living adjustment, which even Social Security provides. Furthermore, DC plans discriminate against women. Teachers are particularly vulnerable under the proposed plan, because when they were pulled from Social Security, they were not given the choice of an SBS plan as state workers were. They do not have that extra 6% contribution match provided state workers who in addition, have a deferred compensation plan. In your December 13, 2004 letter to Alaska's seniors you stated care for Alaska's seniors it is vital to the success of our state. You further stated - "*seniors should not have to choose between paying their rent, buying food or being able to fill prescriptions.*" That is exactly what many seniors will have to do if the legislature does away with a *Defined Benefit plan*.

I urge you to work with the Division of Retirement of Benefits to address health care costs. When Brenda Menge was Benefits Manager for the Division she suggested a HEALTH CARE FORUM, including employees, employers, unions, health care professionals and legislators to work on health care cost containment. We all know this is not a problem unique to Alaska. Alaska can be a role model for health care reform if we choose to work together.

I urge you to reexamine the states' obligation to our model retirement system. As, Sharon Boko, Bob's wife recently stated in comments to Representative John Holm, Fairbanks, "fifty years ago, when this retirement system was started, the employee, employer and state each contributed one-third, for a total of 21% of salary, to the retirement system. In the mid-80's the state funneled their share through the municipalities as revenue sharing. Three years ago, the state stopped this payment and have entirely abrogated their responsibility. The state has contributed greatly to the indebtedness problem - they now expect, under these new proposals, that employee and employer contribute equally, instead of meeting the original intent for each, state, employee and employer, to pay their fair one - third share."

Please encourage legislators to address the real problem, escalating health care costs. Please address it as a state and national problem. You and your daughter, Senator Lisa Murkowski, have been strong proponents of public education and parent involvement. You recognize the importance of attracting a stable quality workforce. - a workforce that will stay in Alaska and contribute to the community and economy, not a workforce that will take its money and run. As one retiree said to me the other day, under a DC plan there would be no incentive to remain in Alaska after retirement. We would lose a valuable resource - retirees contribute their time, expertise, and, yes, retirement pension dollars to each of Alaska's communities.

Please make Alaska proud and keep our Defined Benefit system, work on a model health cost savings initiative and keep Alaska a place where people, as we did, come to make their homes and raise their families. Thank you for your time.

YAHOO! MAIL

Print - Close Window

From: "Cynthia L. Moore" <cmooorelaw@erols.com>
To: "NCTR Membership" <cmooorelaw@erols.com>
Subject: Victory! West Virginia Closes DC Plan to New Hires as of July 1, 2005
Date: Thu, 5 May 2005 16:22:07 -0400

Federal Update 2005-14

May 5, 2005

TO: NCTR Membership
FROM: Cindie Moore, Washington Counsel
RE: Victory! West Virginia Closes DC Plan to New Hires as of July 1, 2005

In a tremendous victory for defined benefit proponents, West Virginia has closed its teachers' defined contribution plan (the DC plan) to **new hires**. Anyone hired on or after July 1, 2005 joins the teachers' defined benefit plan (the DB plan). The total closure of the DC plan to **existing participants** may occur in the future. If the requisite number of participants so approve, the DC plan will merge into the DB plan in Spring 2006 and its participants will join the DB plan. If an insufficient number approve, the DC plan stays in existence. The provisions are part of HB 2984, a massive pension bill.

West Virginia closed its DB plan to anyone hired on or after July 1, 1991. Anyone hired on or after that date participates in the DC plan. West Virginia is the only state to create a mandatory statewide DC plan for teachers (although a very few statewide mandatory DC plans exist for other types of employees). In other states with DC plans, teachers (and other employees, if applicable) have the option whether to participate.

The key provisions of the bill follow:

- **Closure of DC Plan to New Hires:** The DC plan is closed to new members hired for the first time on or after July 1, 2005. The new hires become members of the DB plan. If a merger of the DB and DC plans takes place, all employees will become members of the DB plan effective July 1, 2006.
- **Merger of DB and DC Plans:** Existing DC plan members decide whether their plan should continue. If at least 50% of the members vote in favor of the merger during the election specified in HB 2984, the DC plan ends and the members go into the DB plan. If fewer than 50% approve, the DC plan continues.
- **Education Program:** The Consolidated Public Retirement Board (CPRB), which administers the DB plan, DC plan, and other plans in the state, must begin an educational program for existing DC plan members no later than August 1, 2005. The education program must include information such as the potential advantages and potential disadvantages of remaining in the DC plan or transferring to the DB plan.

- Election: The election may be held by certified mail and begins no later than March 1, 2006 and ends March 12, 2006. CPRB must certify the result to the Governor, Legislature, and DC plan members no later than April 5, 2006.

If you'd like to be removed from this mailing list, please contact me at cmoore@nctr.org.

MERCER

Human Resource Consulting

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206 808 8800 Fax 206 382 0627
www.mercerHR.com

March 18, 2005

Ms. Melanie Millhorn
Director of Retirement and Benefits
State of Alaska
Department of Administration
Division of Retirement and Benefits
P.O. Box 110203
Juneau, AK 99811-0203

*Medical changes
regarding HB 242*

granted 5 yrs July '92 - '03

*Frank '97 settlement - factored in
made everyone whole*

Subject:

Changes in Funded Status - Plan Changes and Ad-Hoc PRPA's

Dear Melanie:

In previous correspondence we provided information regarding the factors that have affected the funded status of the Public Employees' and Teachers' Retirement Systems. Our January 3, 2005 letter analyzed changes in funded status from July 1, 1992 to June 30, 2003. During that time period, changes in plan benefits caused funded status to decline by 4.7% for PERS and 5.3% for TRS. Corresponding increases in the unfunded accrued liability were \$0.3 billion for PERS and \$0.2 billion for TRS. You requested we determine the effect of Ad-Hoc Post Retirement Pension Adjustments (Ad-Hoc PRPA's) compared to other changes in benefits.

	PERS		TRS	
	Change in Funded Status	Increase in UAL (billions)	Change in Funded Status	Increase in UAL (billions)
Change due to Ad-Hoc PRPA's	(3.7)%	\$0.22	(5.1)%	\$0.18
Change due to other benefit changes	(1.0)	0.08	(0.2)	0.02
Total	(4.7)%	\$0.30	(5.3)%	\$0.20

For both PERS and TRS, Ad-Hoc PRPA's were granted in 5 years during the period from July 1, 1992 through June 30, 2003. Other benefit changes were valued in 2001 and 2002 for PERS, and only in 2001 for TRS.

*Lawsuit settled in '96 or '97
accounted for most cost*

*Not much from legis enhancements
In 2001 on Med. Bene*

*17% of Payer
Mercer*

MMC Marsh & McLennan Companies

WILLIAM M.
MERCER

October 26, 2000

Mr. Guy Bell
Director of Retirement and Benefits
State of Alaska
Department of Administration
Division of Retirement and Benefits
P.O. Box 110203
Juneau, AK 99811-0203

Subject: PERS and TRS Surplus Assets

Dear Guy:

In our letter of August 23, 2000 we provided you with estimated costs for a number of proposed changes to PERS and TRS. These changes were initiated by the fact that there are funding surpluses in both Systems as of June 30, 1999. The Boards wanted to review ways of sharing some of these surpluses with members, through benefit improvements, and still maintain a fiscally responsible position with respect to the funding of the Systems and employer contribution rates.

At the August 30, 2000 Joint Board meeting these proposals were reviewed by the Boards and specific packages were recommended by each Board. As you may recall, each of the proposed changes was presented in isolation. We did not combine features of two or more of the proposals together in our original cost estimates. Now that the Boards have recommended specific packages of benefits we can evaluate the combination of changes to get a better estimate of the affect to System costs and funded status.

In addition, we have recently completed an analysis of actuarial assumptions for both Systems. Should the Boards adopt our recommended assumption changes, the funded ratio of both Systems will be reduced. It is possible that one or both Systems could have funded ratios of less than 100% as of June 30, 2000, i.e., there may be no surplus assets on an actuarial valuation basis.

While this possibility exists, evaluating the financial effect of surplus sharing is still applicable. As recent history with the Systems has shown, surpluses can accumulate in favorable market conditions in a relatively short period of time.

William M. Mercer, Incorporated
One Union Square, Suite 3200
600 University Street
Seattle, WA 98101-3137

Phone 206 808 8800
Fax 206 382 0627

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Medicare paym
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Pam
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1 m a g e

8. 20

WILLIAM M.
MERCER

Mr. Guy Bell
August 23, 2000
Page 3

*employee rate
prop to employer rate*

Another item that you have asked us to consider is setting the employee contribution rate proportionate to the average employer rate – a practice used in some other public sector plans. This method would increase (decrease) employee contribution rates along with employer rates and increase (decrease) the liabilities of the System with respect to the return of employee contributions. Taken as a whole and depending on design, it is not clear that there would be system savings or costs associated with this change. Because of this, we would like to discuss this further with you and the Boards before proceeding with any cost analysis.

We are available to answer any questions you may have concerning the above items.

Sincerely,

James W. Jacobson

James W. Jacobson, ASA, MAAA

Brian R. McGee

Brian R. McGee, FSA

JWJ/BRM/jls

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WILLIAM M.
MERCER

August 23, 2000

Mr. Guy Bell
Director of Retirement and Benefits
State of Alaska
Department of Administration
Division of Retirement and Benefits
P.O. Box 110203
Juneau, AK 99811-0203

Subject: PERS and TRS Surplus Assets

Dear Guy:

You have asked us to determine the actuarial impact to the Public Employees' Retirement System (PERS) and the Teachers' Retirement System (TRS) for certain benefit improvements. These improvements would decrease the surplus assets that have accumulated in both systems primarily due to recent investment gains.

Surplus assets for this purpose are defined as the excess of the valuation assets over accrued liability. The surplus in TRS was \$94,679,000 at June 30, 1999. The surplus in PERS was \$218,966,000, taking into consideration the PERS Board adopted target funding ratio of 102%.

The proposed changes are described below:

1. Creation of a "Cash Account" within the current system. Each active member is allocated a \$500 initial account balance. Upon termination after vesting, the member is allowed to take this account balance amount, including a credit of 8.25% interest compounded annually (the current valuation interest rate assumption).
2. Full system-paid medical benefits for Tier II and Tier III members upon reaching 25 (30) years of service for Teachers and Police/Fire (Others).
3. Full system-paid medical benefits when vested and age 60 or older.
4. Full system-paid medical benefits for disabilitants upon reaching normal retirement.
5. A 13th check for current retirees equal to the members' monthly retirement benefit. The average TRS monthly retiree benefit is \$2,388 and the average PERS monthly retiree benefit is \$1,303 at June 30, 1999.
6. Automatic PRPA equal to full Anchorage CPI.

William M. Mercer, Incorporated
One Union Square, Suite 3200
600 University Street
Seattle, WA 98101-3137

Phone 206 808 8800
Fax 206 382 0627

Handwritten notes:
- gains folded into fund to fund Tier II Medical
- Medical part B - need more info from Mercer re: rate for 2001
- assets over list
- assuming 100% funding

*Meritor
recommen
2000 to lower
rate*

*1995 - used 1983
2000*

*will get new report in
Dec from meritor
2005 action in Dec*

	Current Assumption	Proposed Assumption	Change in: Calc. Funding Ratio Contrib. Rate	
Total Inflation	4%	3.5% / 3.75%	1.9%	(1.46%)
Annual Investment Return	8.25%	8.25%	No change	No change
Recognition of Asset Outside 5% Corridor	N/A	Adopt	No change	(3.21%)
Annual Salary Increase - Inflation	4.0%	3.5%	0.7%	(0.82%)
Productivity	0.5%	0.5%		
Merit (first 5 years)	1.0%	1.5%		
Health Premium Trend -	5.5% increase per annum. Blended monthly premium for FY00 is \$459.33. <i>Actual \$530 - for 2000 why lower them?</i>	FY00 - 8.5% FY01 - 7.5% FY02 - 6.5% FY03 - 5.5% FY04-FY08 - 5.0% FY09-FY13 - 4.5% FY14 & later - 4.0% Blended monthly premium for FY00 is \$486.00	(1.3%)	1.01%
Total Turnover Rates	See Table 4 on page 33.	See Table 1 on page 26. Patterns vary by age and service, but proposed rates are generally lower in the first eight years.	No change	0.22%
Disability Rates	See Table 5 on page 34.	No change	No change	No change
Retirement Rates	See Table 6 on page 35.	No change	No change	No change
Assumed Retirement Date if Under Age 50	After 22 years of service.	After 21 years of service.	(0.4%)	0.11%
Mortality Rates	1984 Unisex Pension Mortality Table set forward one year for males and set backward four years for females.	1994 Group Annuity Mortality Basic Table for males and females. 1994 Base Year.	(8.2%)	7.62%
Cost-of-Living Adjustment	62% of retirees receive COLA.	65% of retirees receive COLA.	No change	No change
Total Change due to Proposed Assumptions			(7.3%)	3.47%

over 20yr at 20% would be

Table

includes fact that Medicare premium after age 65

Reason for change is calc infl

Increased mortality 10% inc in disabilities

*Assumptions for 2000
new ones set this fall*

Brain don't always use most current mortality depends on history

Before rec.

After rec.

Current

Dec 8

Calc Cont employer

7.09%

10.56%

11%

Calc fund

112.5%

95.2%

from June 30, 1999

Wouldn't adopt til June 30, 2001

economic assumptions

*Current 14%
CPD for 55 3.5%
all lower with
lower contrib rate*

William M. Mercer, Incorporated

Teachers' Retirement System
Analysis of Actuarial Assumptions

Charlie: request review in 2yr rather than 5yr

*7.09%
112.5%*

Ginny Austerman

From: Ginny Austerman
Sent: Wednesday, July 13, 2005 10:17 AM
To: 'William Blackburn'
Subject: RE: PERS/ters hearing (includes typo corrections)

Thank you, William. I have given Rep. Weyhrauch a copy of this email.

Ginny

From: William Blackburn [mailto:webjno@gci.net]
Sent: Tuesday, July 12, 2005 7:49 PM
To: Ginny Austerman
Subject: Fw: PERS/ters hearing (includes typo corrections)

----- Original Message -----

From: William Blackburn
To: Ginny_Austerman@legis.state.ak.us
Sent: Tuesday, July 12, 2005 7:42 PM
Subject: PERS/ters hearing

I do hope that this hearing will address the shortcomings of the Administration that let to this situation of the fiscal shortages in the fund. Someone was not doing their job to let this get so out of hand. I cannot place further trust in the administration of our retirement fund until the misdeeds of the Retirement and Benefits are rectified, and the sooner the better. William E. Blackburn, 4143 Aspen St., Juneau, Alaska, 99801. Please include this e mail as my testimony for the hearing in Anchorage, and get a copy to Rep> Weyhrauch. Thank you.

JUL 15 2005

Gary Miller
20135 Cohen Dr
Juneau, AK 99801-8211

Representative Bruce Weyhrauch
State Capitol Room
Juneau, AK 99801-1182

The \$5.7 billion PERS trust fund shortfall is over a 25-year period. In other words it is \$228 million per year. Part of the short fall was caused because the State reduced its payments by over \$460 million. The State needs to increase its payments.

The State needs to stop hiring contract workers and retirees who come back to work. We had contract workers where I worked who we paid \$150 to \$200 per hour. Pay overtime wages instead of hiring contractors. Some money from the overtime wages would go into the retirement trust fund. Retirees who come back to work fill a position that then no longer contributes payments to the retirement trust fund. Stop hiring retirees back.

Both the State and state employees benefit from a good retirement system. The State benefits by making jobs more attractive. The State is currently in a crisis because of problems having trouble hiring new employees. A good retirement system helps both attract new employees and keep the trained and experienced employees. State employees benefit because they can look forward to a secure retirement after a career with the State. State employees may need to contribute more to their retirement.

Health care costs have risen several times the rate of inflation. There are several reasons for this that I am aware of.

Drug companies spend 13% for development but 30% for advertising. They are also spending huge amounts of money defending themselves in court. The people of the U.S. pay the highest cost for drugs in the world. Canadian drugs are much less expensive but President Bush and the drug companies are successfully keeping Alaskans from being able to buy drugs from Canada. The solution is for the State to set up its own pharmacies and sell the drugs at cost to public employees and retirees. There are 90,000 active and retired public employees.

Doctors pay huge insurance premiums for their malpractice insurance. In reality, we pay for the malpractice insurance through higher medical bills. If you watch the commercials on television you see attorneys drumming up lawsuits. The solution is to limit how much money an attorney can receive per hour if they loose a case. This will reduce the number of frivolous cases and should reduce malpractice insurance and thus healthcare costs.

The State offers free health care for the poor. Having health centers where nurses, not highly paid doctors, perform the assessments and checkups saves money. The patients are referred to doctors only when necessary. The same should be done for public employees and retirees. State health centers staffed by nurse practitioners should be set up for active and retired public employees.

Tobacco, alcohol, obesity etc. are all causes of increased healthcare costs. Approximately 26% of Americans smoke. Over 50% of Americans are overweight. Wellness programs may help people become and stay healthier, thus saving money. Setup wellness programs for active and retired public employees.

Annual physicals catch medical problems early and reduce the cost of treatment. I had a melanoma removed that had been discovered during my annual physical. Because it was found early I did not need chemotherapy or radiation. Health insurance should cover one physical per year. Dental cleaning is covered by insurance because it catches problems early and reduces dental costs. Annual physicals could do the same thing.

Please consider the above problems and solutions.

Thank you.

Gary Miller
Retired state employee

Gary Miller
20135 Cohen Dr
Juneau, AK 99801-8211

Representative Bruce Weyhrauch
State Capitol Room
Juneau, AK 99801-1182

I would like to add one comment to my previous suggestions. Factors affecting the PERS trust fund vary. Changes in the stock market, health care costs etc. affect the balance of the fund. Contributions to the fund are fixed. The contribution rate for the employees and employers should vary based on actuarial projections.

Thank you.

Gary Miller
Retired state employee

Gary Miller
20135 Cohen Dr
Juneau, AK 99801-8211

Representative Bruce Weyhrauch
State Capitol Room
Juneau, AK 99801-1182

I would like to add yet another comment to my previous suggestions. Since AETNA processes the medical claims, they make a profit that reduces the money available for claims. A study should be done to see if the State of Alaska could process the claims for less money than what AETNA charges. Even if the cost turns out to be the same, bringing the work from down South back to Alaska will create Alaskan jobs. The State of Alaska may be able to process insurance claims for less money than what AETNA charges.

Thank you.

Gary Miller
Retired state employee

Ginny Austerman

From: Bruce Weyhrauch [whyrock@gci.net]
Sent: Friday, July 15, 2005 4:04 PM
To: Ginny Austerman
Subject: FW: Pensions

file

From: David M. Reaume [mailto:dreaume@camano.net]
Sent: Thursday, July 14, 2005 3:31 PM
To: Bruce Weyhrauch
Subject: Pensions

Bruce:

I have been listening to the hearing today. As I write this Melanie Milhorn is testifying. My reaction is that fund valuation is being over emphasized. You really do not need another actuarial opinion to know that the funds are in trouble. Whether the shortfall is \$ 5 billion or \$ 10 billion is almost academic. Beyond a certain point, numbers are just "BIG." The focus now should be more balanced with a close look on how changes in the plans affect representative employees and pensioners. In other words, the macro problem is clear enough and the causes of the problem are clear enough. The issue now is how to fix it given budget constraints and how various proposed fixes affect not only the actuarial valuation but also the representative employee.

In particular, hiring a "health actuary" as suggested by Mr. Esuchanko is, in my opinion, an exercise with limited value because no one really knows how the country's health care crisis (continuous increases in spending) will turn out. Mercer's health care cost projections may be conservative as suggested by Mr Esuchanko but given the state's implicit budget constraints, knowing that the problem may be even more severe would likely have very little effect on the choice of solution. Knowing just how much more severe the health care problem may become is nice but not essential to the problem at hand because you probably could not pass legislation that dealt with shortfalls much greater than those projected by Mercer.

DMR

Ginny Austerman

From: Rep. Bruce Weyhrauch
Sent: Tuesday, July 19, 2005 9:28 AM
To: Bruce Weyhrauch
Cc: Ginny Austerman
Subject: FW: Alaska's aging population chart

From: Luby, John Patrick [mailto:JLuby@aarp.org]
Sent: Friday, July 15, 2005 12:41 PM
To: Rep. Bruce Weyhrauch; Rep. Mike Kelly; Rep. Max Gruenberg; Rep. Peggy Wilson; Rep. David Guttenberg; Rep. Ethan Berkowitz; Sen. Hollis French; Rep. Carl Moses; Rep. Norman Rokeberg; Rep. Paul Seaton; Rep. Ralph Samuels; Rep. Kurt Olson
Cc: Sam Trivett; barbara rich; Liz Lucas (E-mail); fjenkins@ak.org; George Hieronymus; Mary Schaeffer
Subject: Alaska's aging population chart

In yesterday's Ways and Means hearing, Representative Wilson asked about the percentages of older Alaskans compared to children after the comment about ten states with more older persons than kids. Currently we have the smallest percentage of older persons in the entire country. Only 5.7 % of our population is over 65 compared to 12.4 % nationally. Alaskans traditionally are younger but we are seeing significant changes. We took the raw numbers produced by the Department of Labor and graphed them (see below). We definitely are going through a significant "graying" of our population. In addition, there has been a complete turn-around in the numbers of retirees who leave Alaska upon retirement. Only Nevada has a higher percentage of retirees who are determining to remain in their home state and not relocate. Before 1990, many Alaskans left. By 2000, that trend reversed and our folks are staying here after they retire. AARP would be glad to secure any additional population info that may help you in your deliberations.

Ginny Austerman

From: John A. Lund [jalund@gci.net]
Sent: Friday, July 15, 2005 12:13 PM
To: Ginny Austerman
Cc: Rep. Ralph Samuels
Subject: Re: TRS/PERS

Open letter to the House Ways and Means Committee:

Good Morning. Will anybody be testifying as to how much the early buyouts (RIP programs) cost the retirement systems? Or how much medical costs were incurred by the system from members that where allowed to retire early? (with TRS it would be three years, and during those three years are there any figures as to major medical costs that would have been the responsibility of the school districts but now are the retirement systems...i.e. cancer, bone marrow transplants)

It is one task to evaluate the general health of the system, it is another to assess the added costs brought about by the changes (loopholes) to the system. And how those changes effected the fiscal and actuarial health of the system.

How would the systems fiscal health be if we had no early buyouts, and part time employees were not given full time lifetime health insurance?

The question is for the committee is, was it the perfect storm of high medical costs, increased life expectancy, and stock market losses, or was it government creating additions to the system that drained its fiscal stability? The state funding public services through the retirement system.....i.e. the retire/rehire program, granting half time legislator's full time health benefits?

Or why major unions in the state did not cry out to have the retire/rehire program revoked?

Any figures on retired/rehired individuals having major medical operations during the period they were on retired/rehired status?
(i.e. the retirement system rather than the retire/rehire employer picked up the costs)

Please have testimony on the "additions" to the system which created stress to the retirement systems fiscal health.

Yes, we have a contract with the state employees. Do we have a contract with the loopholes that were created?

Also, I have been told that a preferred hospital (not providers) and generic drugs would greatly decrease raising health costs.

Why is that not being addressed? Members could go to a non preferred hospital and use brand named drugs but that additional cost would be their responsibility.

The permanent fund always had Rick Halford and Jay Hammond to protect it's fiscal health. Sadly, the retirement systems' had no protectors. Greed and lack of oversight ruled the day.

Please submit this for the record. I would be available for testimony if asked.

Thanks

John Lund

Ginny Austerman

From: John A. Lund [jalund@gci.net]
Sent: Saturday, July 16, 2005 1:32 AM
To: Ginny Austerman; Sen. Ben Stevens; Rep. Mike Hawker
Cc: Rep. Ralph Samuels; Rep. Max Gruenberg
Subject: Fw: Article

Please add this to the mix. I knew when I wrote this I would be criticized. I'm protecting the person who sent this to me which is only fair. However the dialogue needs to be elevated.....]]

Good to hear from you. My only point is there was a rush to access the resources of the retirement systems. I don't believe there was enough due diligence or caution before accepting what the actuaries said. Was there any second opinion by other firms? The actuaries were taken at face value because that is what folks at that time wanted to hear. Everyone wanted an early out. And in the end, that was beginning of the decline of a once great system.

The system questioned investment presentations and systematically invested wisely. Why was this not done with the actuaries?

The answer is simple, too many folks wanted their districts to participate in the RIP programs and the consequences to the system were overlooked.

I know many will disagree with me. The system can work if it is allowed to stay actuarially intact and not tampered with by the legislature or special interest groups.

I hope all is well in your world. Thanks for the reply.

John

John,

When the retire/rehire bill was in the legislature a few years ago, we (-Alaska) raised questions about how it would impact the system. The response from the actuaries hired by the division of retirement and benefits was that there'd be no impact.

Terry Harvey

From: Ginny Austerman
Sent: Monday, August 01, 2005 2:46 PM
To: Terry Harvey
Subject: FW: Quick Follow up

Thanks, John. I'll add this to your other comments.

Ginny

From: John A. Lund [mailto:jalund@gci.net]
Sent: Thursday, July 28, 2005 9:37 PM
To: Ginny Austerman; Rep. Max Gruenberg; Rep. Mike Hawker; Rep. Ralph Samuels
Subject: Quick Follow up

Good evening. My only point is after 25 years of a record bull market in equities, we will see a period of restrained growth. And higher energy prices, and the costs for terrorist protection, will take time to show a gradual raise in inflation.

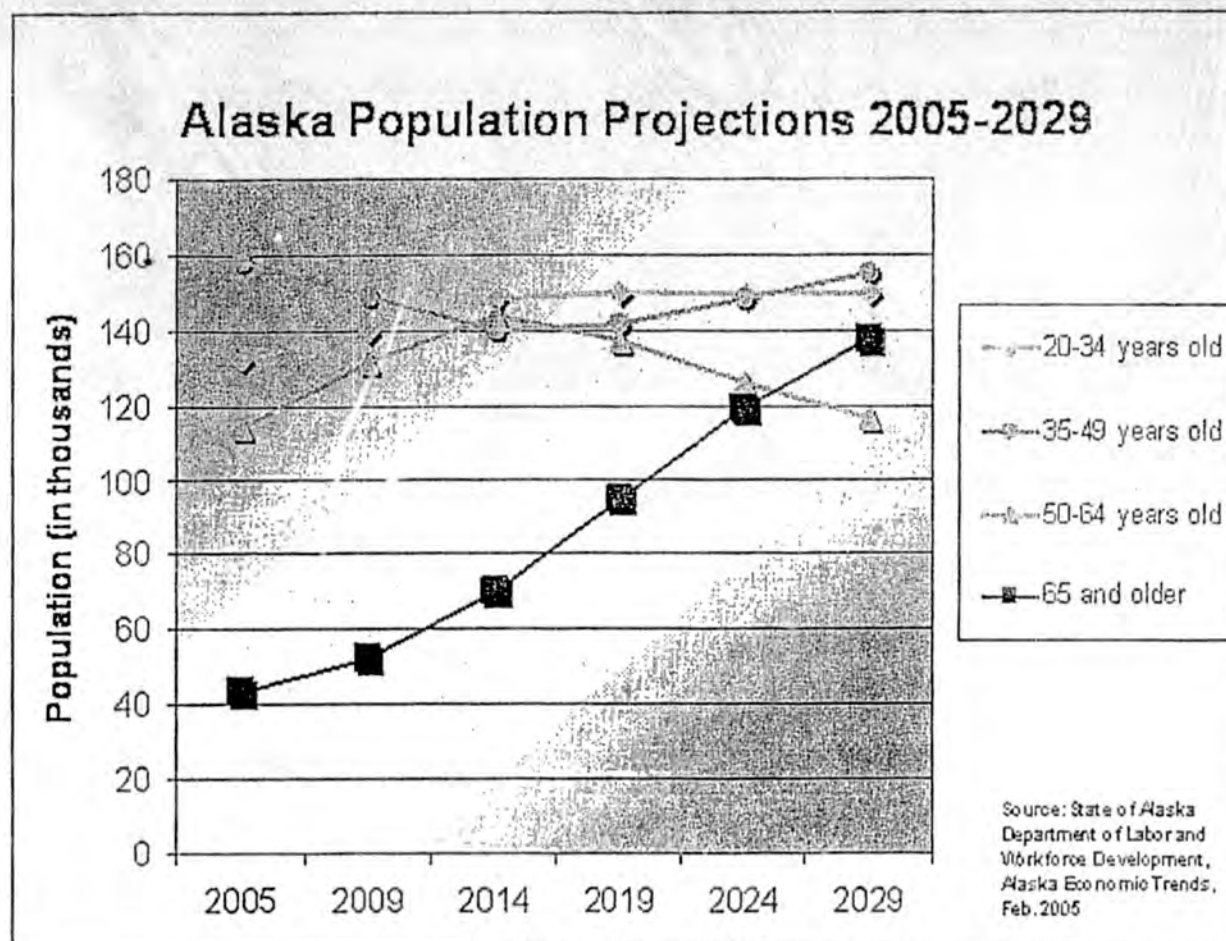
And the outside factors of possible terrorist attacks or disruptions, and the pending pension crisis in our country, added to a possible real estate bubble, would encourage me to go conservative on my estimates for stock market appreciation and continued low inflation.

If correct you have hedged your bets and can further reduce the unfunded liabilities, if wrong you have increased the unfunded liability and compounded the problem.

My rule of thumb would be always go a half a percent of what the permanent fund projects for capital appreciation and read their inflation outlook.

I appreciate all you are doing.

John Lund



Alaska's aged population is expanding.

In 2003, Alaska's population was about 649,000, with 6.3% being age 65 and older (41,000 residents).¹ Unlike any other age group, Alaskans age 65+ is currently growing at three percent annually. Comparatively, the growth rate for *all other age groups* is just 1%.²

¹ OASDI Beneficiaries by State and County, 2003. Social Security Administration:
http://www.ssa.gov/policy/docs/statcomps/oasdi_sc/2003/table1.html

² Alaska Economic Trends Population Projections 2005-2029, State of Alaska Department of Labor and Workforce Development.
<http://www.labor.state.ak.us/trends/feb05.pdf>

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8/24/2005

Representative Bruce Weyhrauch
House Ways and Means
State Capitol, Room 421
Juneau, AK 99801-1182

RE: PERS/TRS Funding Shortfall

I speak for myself in this writing, but as a PERS/TRS retiree, I am an active member of the Retired Public Employees of Alaska (RPEA). Through that organization, I have had an opportunity to communicate with many PERS and TRS retirees. My impression is that there is a general feeling that retired State of Alaska employees have received unfair treatment at the hands of those we elected to represent us. On reviewing the actions of the legislature last session, it appears to me that nothing has been done for retirees, and the only fix "for" new employees has been to cut benefits. The subject of this hearing is on the retiree funding shortfall, so I will stick to that.

When I was working for the State of Alaska, not once was I allowed to be involved in the decision making on my contribution rate or any issue related to how much would be set aside from me or by my employer for my retirement benefit. I did give up wage increases a number of times because the state was going through a rough patch. With that I was promised all along that my health benefits would remain at the same level as promised when I was hired. Instead, there is the constant threat of another diminishment of benefits around the corner.

Now, retirees are being asked to accept less than promised. We are being told that the shortfall is our fault, or the fault of the retirement boards upon which we had some representation. No one talks about the fact that the administration has always had final say over the boards, and that laws governing retirement issues were all passed by vote in the legislature. No one mentions that boards upon which retirees had representation questioned too rosy actuarial reports, and those questions and recommendations were unheeded by administration officials.

Therefore, it is up to the administration and the legislature to fix the shortfall. Begin by using common sense actuarial methods similar to those of almost every state in the Union except Alaska. Use realistic funding levels, again like most other states use. Pay off the under funding over time, by some legislative methods that you were

ected to figure out. It is the legislature's and the governor's responsibility to make sound decisions in every area of state government. This case is no different. The sooner the legislature begins work on the actual problem, instead of placing blame on everything except the sources of the problem, the faster the red ink will begin to disappear.

In addition, allowing retirees to participate in solutions, as in the case of the PERS and TRS boards, you might find more savings to be had. As a result of past cooperation, we now have about the highest possible savings from using generic prescription drugs that is possible until some newer brands become generic. I and others in my circle are worried that lack of oversight with the new ARM board will result in the escalated erosion of our retirement funds. Please take positive action to fix the increasing funding problem.

I thank each of you who are involved in looking for solutions. You are giving additional time to solving problems that should not have remained on your plate at such a late date. I truly appreciate your service to the people of Alaska.

Sincerely,

Doris Robbins

cc:

Representative Rokeberg
Representative Samuels
Representative Seaton
Representative Wilson
Representative Gruenberg
Representative Moses

Ginny Austerman

From: Rep. Bruce Weyhrauch
Sent: Monday, July 11, 2005 2:20 PM
To: Bruce Weyhrauch
Cc: Ginny Austerman
Subject: FW: TRS

From: John A. Lund [mailto:jalund@gci.net]
Sent: Monday, July 11, 2005 12:54 PM
To: Rep. Bruce Weyhrauch
Subject: TRS

VITAL SIGNS

Employers' differing stances on health
Unions, profitability, industry affect coverage decisions

By Kristen Gerencher, MarketWatch
Last Update: 7:22 PM ET July 7, 2005

SAN FRANCISCO (MarketWatch) -- When it comes to providing health care for their workers, companies vary widely in how they perceive costs and value.

At one end of the spectrum are the companies that pay 100% of the health premiums for their employees and seek to hold down costs in the health plans themselves. On the other end are firms that ask workers to pick up a bigger percentage of the tab and implement high-deductible plans that pin more of the health-care decision-making on employees as well.

With health-care costs continuing their rapid rise, just what persuades one company to absorb most of the cost increases while another passes the hikes on to workers or scales back coverage?

"The way a company looks at that question is going to be shaped by what industry they're in, what their cost pressures are, what their competitor does, how profitable they are," said Tom Billet, senior consultant for Watson Wyatt, a benefits consultant in Stamford, Conn. "Those are all key factors.

"Beyond that... I would say there's one constant in today's environment and that is very few companies if any that feel they have to have a top-of-the-line plan to attract and retain employees. More companies look at it as they want to make sure they have a competitive plan."

The kind of coverage a company offers and the amount of the tab it picks up depends on variables ranging from labor relations to profitability to executives' personal

beliefs, benefits experts said.

Such factors make the experience at General Motors or Starbucks, for example, vastly different from that of other employers.

Holding on to top benefits

The strength of unions, despite a decline in recent years, remains instrumental in some sectors.

General Motors ([GM: news, chart, profile](#)) is embroiled in a long battle to enlist union support in getting its medical costs under control as it now spends more on current and former workers' health care than it does on steel.

The automaker's woes are more extreme than those of many other companies because it hasn't yet successfully bargained to participate in employee cost-sharing, the dominant cost-control strategy that emerged after consumers rejected tightly managed care in the 1990s, said Paul Ginsburg, president of the Center for Studying Health System Change.

"The auto companies always had the richest health benefits," Ginsburg said. "Some other unions have made concessions recognizing it was coming out of wages and they had some interest in containing health-care costs."

Part of GM's dilemma is that "it's usually harder to take something away that exists," said Ron Pollack, executive director of Families USA, a consumer advocacy group.

"There are some industries and some companies where it may be harder to take back just because of how much a tradition this has become in terms of the coverage they've had for many years," Pollack said.

Star-bucking the trend

Despite the cost pressures, some executives have taken a strong position, Pollack said. "[Chairman Howard] Schultz at Starbucks is proud that he provides significant coverage for his workers. There are some companies and some industries where that's more prevalent than others."

For 20 years, Starbucks ([SBUX: news, chart, profile](#)) has provided health care for all eligible workers, including part-time staff who work about 20 hours a week, spokeswoman Sanja Gould said. "We have created PPO plans designed to provide coverage that is affordable to all partners while providing comprehensive coverage."

The vast majority of workers who participate enroll in one of two PPO plans that have deductibles ranging from \$100 to \$225, she said. Starbucks covers about 75% of the premium costs while workers pick up 25%, and the company currently has no plans to change its offerings for next year.

"The health benefit is a key component of the Starbucks business model," Gould

said. "By providing a health benefit, Starbucks is able to reduce partner turnover, attract higher quality applicants and ultimately foster a more fulfilled, productive and healthy partner in the short and long term."

Playing defense

Starbucks is unusual in the retail sector, which isn't known for many, if any, health benefits. Wal-Mart, for instance, has come under fire for having a large share of its workers enroll in public health-care programs, putting taxpayers on the hook for benefits critics say the company should offer.

Wal-Mart ([WMT: news, chart, profile](#)) spokesman Dan Fogleman said the company tries to make its plan affordable for workers, whose national average hourly wage is \$9.68. The company's self-insured traditional 80-20 plan offers eight options, with deductibles ranging from \$350 to \$1,000 a year, he said.

"A lot of people don't realize we offer benefits to both full and part-time associates, which sets us apart within the retail industry," he said.

Wal-Mart, which Fogleman said has thin profit margins, picks up about two-thirds of the premium costs and "associates" carry about one-third. Single workers can get insurance for less than \$40 a month and family premiums typically run \$155, he said.

While plans for 2006 are still being considered, "we are very interested in and are looking at adding HSAs to our offerings," he said, referring to health savings accounts, which are new worker-owned, high-deductible plans that function like tax-free investment accounts for offsetting health expenses.

Some companies take great pains to shield their workers from health-care costs.

Analytical Graphics in Exton, Pa., was one of 20 firms making the list of 50 "Best Small and Medium Companies to Work For" that covers 100% of workers' health premiums. Only 14 of Fortune's "100 Best Companies to Work For" cover that much of their workers' health care, according to the Great Place to Work Institute. [See full story.](#)

Still, premium costs are just one measure of a company's approach to health care, Billet said.

"Just because a company doesn't have payroll contributions doesn't mean it has a great plan," he said. "They might have very high cost-sharing in the plan itself."

The most prevalent arrangement at big companies is for the employer to shoulder 80% of the cost increases while workers take on 20%, though that split is shifting toward 75-25, Billet said.

Lisa Velte, director of human resources for Analytical Graphics, said the point-of-service plan that has no premium cost to employees is one of four plans the company offers. It's considering replacing one of its other PPO or HMO offerings with an HSA next year, she said, noting that there aren't a lot of HSA options on the market yet.

The software firm's 240 workers are fairly young and healthy -- 37 is the average age -- and that may help the company get a handle on its 11% projected health-care cost increase for 2005-06.

"We try to structure the plan as best we can to control the costs," Velte said. "It's the fastest growing part of our employee investment, but it hasn't been as bad as the rest of the industry."

"We also know that making this investment in our employees is extremely valuable," she added. "It's a retention and attraction tool."

To be sure, privately held firms may find it easier to offer generous medical benefits because they don't have to answer to shareholders as do their publicly traded counterparts, and large companies that self-insure can make comparisons difficult, said Billet, of Watson Wyatt.

In fact, more small firms have stopped offering coverage altogether in the last few years, with just 63% providing it last year compared with 68% in 2001, according to the Kaiser Family Foundation. The percentage of all workers getting employer-sponsored care fell to 61% from 65%.

Kristen Gerencher is a reporter for MarketWatch in San Francisco.

Bruce,

I thought you would find this interesting.....

John Lund

Ginny Austerman

From: John A. Lund [jalund@gci.net]
 Sent: Thursday, July 28, 2005 12:07 PM
 To: Ginny Austerman; Rep. Max Gruenberg; Rep. Mike Hawker
 Cc: Rep. Ralph Samuels
 Subject: TRS

Good Morning. Just can't get out of this print. Two points, one, inflation will probalby be up, and two, you can't expect high upper digit returns. To me, inflation will be higher than 2.6% and a 6.5% return on investments is more realistic.

I have enclosed two articles to look at.

John Lund

Mercer's Assumptions

Alaska's Experience

Inflation will be 3.5%	2.6% over any ten year period; PF uses 3%.
Wage Growth 3.75-4.5%	1.36%
Investment return 8.25%	9% over any ten-year period
Health Care Costs 12.5% - 5%	8% (7.5% according to Esuchanko)

The Street.com

What's ahead as China revalues the yuan
 By Tony Crescenzi 7/28/2005

China's revaluation of its currency, the yuan, has varied implications. Here I'll present several of them along with other key points and facts and figures on the issue.

The Treasury market's initial reaction was overdone, as China's monthly purchases of Treasurys are not likely to change much anytime soon. The revalue isn't likely to result in more than \$1 billion in monthly impact at most, and this is a stretch. With Treasurys trading nearly \$600 billion per day, such a sum would be a drop in the bucket.

The \$1 billion maximum forecast is derived by considering that China has been purchasing about \$2.3 billion of coupon Treasurys monthly over the past year, in addition to about

advertisement

\$1.8 billion of T-bills. Thus, China's total monthly purchases of Treasuries have averaged about \$4 billion per month. It seems unlikely that the modest yuan revaluation would alter the monthly tally by more than several hundred million dollars per month.

Moreover, even with full flexibility, China is likely to continue to accumulate Treasuries, just as Japan has been a large buyer for many years despite having a fully flexible foreign exchange system. The main reason is because China, like Japan, earns large amounts of dollar reserves on a daily basis. Many of these dollars will flow back into the Treasury market.

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What it means for inflation

The impact on inflation will be minimal. For each 1% rally in the yuan, import prices will rise by about 0.14%, given that China accounts for about 14% of all U.S. imports. The impact is actually likely to be smaller than that, assuming substitution effects and the fact that some of the U.S.-China trade is being conducted in dollars. A 10% revalue would thus boost import prices by about 1.4%. The impact on U.S. consumer prices would be diminished by the fact that the \$215 billion in annual imports from China are a very small part of the \$12 trillion U.S. economy. It would thus take a 5% revaluation of the yuan to move the consumer price index 0.1%, again assuming no substitution effects (unlikely) and the false assumption that all of the trade between the U.S. and China is transacted in yuan.

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For those who worry that China will sell some of its Treasury holdings when it begins to diversify its reserve assets, it should be noted that Japan, which holds \$685 billion of Treasuries, has been diversifying its reserve assets since August and has hence been a net seller of Treasuries, yet interest rates have nonetheless fallen for the most part since then. In the same way, if China were to diversify its assets, the impact would likewise be minimal and readily absorbed, especially with the U.S. budget deficit on the way down, which is freeing up tens of billions of investment dollars.

China's impact on the U.S. fixed-income market extends beyond Treasuries. Over the past year, China bought about \$19 billion of U.S. corporate bonds and \$17.2 billion of agency securities. Here too, however, the sums are too small to impact the main dynamics shaping these markets. Nevertheless, to the extent that the corporate and agency markets are smaller markets than the U.S. Treasury market, the impact could be greater, albeit small.

The rest of the story

There is a secular story here related to labor costs and inflation that may be bearish for the bond market but which will take many years to play out. China's revaluation symbolizes its emergence as an economic power and its increased status, and this should benefit Chinese households by boosting incomes there. As China's labor costs rise, the disinflationary effects from China that have helped keep global inflation low over recent years will wane, thus boosting inflation. Nevertheless, with labor costs at roughly 30 cents per hour in much of China, it will be many years before Chinese labor costs are high enough to provide much of an upward thrust to global

inflation.

Future moves toward flexibility of the yuan are likely to coincide with China's economic news. It is no coincidence, for example, that China announced its revaluation just a few days after it reported strong GDP data. The timing of the announcement was likely a signal about what would likely be a catalyst to future revaluations. China's fixed-exchange-rate regime has been a source of economic strength because it has invited the inflow of foreign capital. It's akin to eBay (EBAY, news, msgs) keeping its stock price at \$80 while its value has actually increased to \$300+. If such a situation existed, investors would pour money into eBay, recognizing the cheapness of its shares. Similarly, the fixed regime in China has made China a cheap investment, and money has poured in. This creates the risk of imbalances such as excess capacity, something that revaluations will help to avoid.

China likely wants to keep its currency somewhat overvalued to allow for a cushion against weakness when economic growth eventually slows and hence the veritable exit from one door commences.

China is unlikely to move toward a fully-flexible exchange rate for at least several years, as China will want to protect its economic gains via the relative stability of the U.S. dollar. China is already hinting as much, judging by comments that Li Deshui, a member of the Bank of China's monetary committee, delivered in an interview with Bloomberg. He said it would be at least five years before China moved toward full convertibility of the yuan because if it were done sooner, there would be a risk of speculation against the currency, as was seen against the Korean won and the Thai baht in 1997. Such speculation would be possible if China's economic growth was to slow and its banking sector's woes were hence put under greater scrutiny.

The speed of future yuan revaluations will be dictated in part by the actions of the Federal Reserve and the impact that the Fed's actions have on the value of the U.S. dollar. For example, if the Fed were to cut interest rates, hence creating a downward tendency for the dollar, the Chinese might speed the pace of future revaluations, as it would fit naturally with the fact that other currencies are rising faster against the dollar, too. Conversely, when the Fed raises interest rates and the dollar rallies, the Chinese are likely to slow the pace of revaluation, as it would fit with the fact that the dollar is rising in value against other currencies.

Tony Crescenzi is the chief bond market strategist at Miller Tabak + Co., LLC, and advises many of the nation's top institutional investors on issues related to the bond market, the economy and other macro-related issues. At the request of the Federal Reserve, Crescenzi is a regular participant in the board's Livingston Survey of economic forecasters. He is also the author of "The Strategic Bond Investor." At the time of publication, Crescenzi or Miller Tabak had no positions in the securities mentioned in this column, although holdings can change at any time. Under no circumstances does the information in this column represent a recommendation to buy or sell stocks. Crescenzi also is the founder of Bondtalk.com, a popular Web site covering the bond market and the economy.

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Yuan Revaluation

- The impact of China's yuan revaluation will be felt far and wide.
- China is likely to keep accumulating U.S. Treasuries because it earns large amounts of dollar reserves on a daily basis.
- China is unlikely to move toward a fully-flexible exchange rate for at least several years.

Stock-Market Returns May Not Meet Bush's Social Security Hopes

March 28 (Bloomberg) -- President George W. Bush, promoting his plan to set up private Social Security accounts, is betting that stock returns will remain strong even as economic growth slows. Economists and equity strategists aren't so sure.

Bush is using forecasts from the Social Security Administration that say the economy will expand less than 2 percent a year -- the slowest sustained rate since the 1930s -- after 2020 as population growth eases. At the same time, the agency projects that stocks will return an annual average of 6.5 percent after inflation.

Thirty-nine of 58 economists and strategists surveyed by Bloomberg News say that if the economy slows that much, Bush's stock outlook is too optimistic. Over the last 50 years, as the U.S. economy grew 3.4 percent a year on average, almost twice as much as the agency is forecasting, the Standard & Poor's 500 Stock Index returned only 6.8 percent after dividends were reinvested.

"A 6.5 percent real equity return is not realistic" at the growth rates being projected, says Thomas McManus, chief investment strategist in New York at Banc of America Securities LLC. "If it were, we will not have a Social Security problem in 2050 because shareholders will be so wealthy they could easily fund the shortfall."

Neal Soss, managing director and chief economist at Credit Suisse First Boston Inc. in New York, says that "real growth of 1.9% and real stock market returns of 6.5% can go together for a significant stretch of time, but not in perpetuity. Among other things, that combination would suggest that eventually all of national income was being paid as profits with no wages at all, or alternatively that price-earnings multiples were rising without limit."

'Way Too Low'

If the economy grows faster, the problems with Social Security won't require the overhaul Bush is proposing, several economists say.

"These GDP estimates are way too low, even with a slowing workforce due to retirees," says Chris Rupkey, senior financial economist at Bank of Tokyo-Mitsubishi in New York. "With GDP faster than their assumption, there will be more money in the trust fund, or we will have paid down some debt with potential budget surpluses so we can borrow again to get through the baby-boom retirement period."

The possibility of low stock-market returns could undercut the main arguments that Bush, Vice President Dick Cheney and Treasury Secretary John Snow are using as they try to convince the public that personal accounts invested in equity and bond index funds can result in bigger benefits for future retirees.

Exhausted of Assets

The Social Security trustees said on March 23 that the 70-year-old program will be exhausted of assets by 2041. The White House is using such forecasts to bolster its case that workers should be allowed to divert payroll taxes into higher-yielding private accounts.

Under the current system, Social Security funds are invested in Treasury bonds. The Social Security trustees project a 3 percent long-term return for the bonds, and Bush says the stock and bond markets will do better.

"The point is, the individual would get a higher rate of return than if they just send their money to Social Security," Cheney told an audience in Bakersfield, California, on March 21.

Economists such as Robert Shiller of Yale University say counting on averages from the

past to predict returns decades from now is dangerous. "These historical returns are not, however, a good guide to future returns," Shiller said in a research paper released last week.

A Lucky Experience?

"The United States economy and stock market performed extremely well over the last century," he wrote. "Many factors suggest this lucky experience is not likely to be repeated."

He cited forecasts for lower economic growth and the current historically high stock values. The price-earnings ratio for the Standard & Poor's 500 index from 1936 through 1990 was 13.2 on average; it rose to an average 24.8 from 1991 through 2003, according to S&P data. The ratio was 19.6 as of March 24.

Shiller wrote the 2000 book "Irrational Exuberance," which chronicles the 1990s stock boom and the phrase Federal Reserve Chairman Alan Greenspan made famous in a 1996 speech warning about a possible bubble in the equity market.

The White House Council of Economic Advisers said in a Feb. 4 statement that investment returns don't necessarily have any relation to economic growth. Greenspan echoed that view in testimony before the Senate Committee on Aging on March 15, saying that stock prices are closely related to investors' expectations of future earnings, reflected in price-earnings ratios, not just economic growth.

Slower Profit Growth

"It is the case if you have a slower economy that profits will grow at a slower rate," Greenspan said. "But remember, a very significant part as far as equities is concerned is the price-earnings ratio."

He added, "It's ambiguous as to what that will do over time. And I wish we could forecast that better, but we don't seem to do that all that well."

A Bloomberg analysis shows a strong correlation between investment returns and economic growth over the last 50 years. Gains and declines in the S&P 500 index preceded corresponding gains in gross domestic product and losses by about a year. The correlation coefficient was 0.92, with 1 being a perfect correlation.

Greenspan said workers close to retirement shouldn't be exposed to risk and should be largely invested in bonds. Bush and the Social Security Administration are also recommending that workers hedge their risk. They're touting a "lifecycle portfolio," where older workers invest more in bonds than stocks.

Lifecycle Returns

Lifecycle-account returns may be even less than the 3 percent annual yields that the Social Security Administration forecasts for Treasury bonds over 75 years. Shiller analyzed 91 different scenarios for a worker born in 1990, and the median return was 2.6 percent.

McManus and 46 of the other 57 economists and strategists polled said the Social Security Administration's economic-growth forecast was too low, and that higher growth would yield better returns on stocks. Twenty of those surveyed said stock market returns would likely match or exceed the historic average.

If their prediction is true, it tempers the urgency to overhaul the federal retirement program, as higher economic growth results in increased wages and more workers, with more tax revenue going into the pension system.

"This low estimate ignores the potentials for immigration growth, an increase in the retirement age and significant productivity growth stemming from technology enhancements," says Ernest Goss, an economist at Creighton University in Omaha, Nebraska, and former scholar-in-residence at the Congressional Budget Office.

Productivity

Treasury's Snow says high stock-market returns will be possible because gains in productivity -- or output per worker -- will continue to be strong, offsetting slowing population growth.

GDP growth is a function of both growth in the workforce and productivity, he said in a March 23 interview. "Productivity stays strong, and productivity per capita remains high," predicted Snow, who has a Ph.D. in economics. "And it's productivity per capita that drives returns on assets."

Yet the Social Security Administration expects productivity growth to plummet in the coming years, falling from last year's 4.1 percent gain to about 2.1 percent starting in 2010, according to the agency trustees' report released March 23.

Better Solution

Many economists who say Bush's forecast for investment returns is unrealistic still say private accounts are a better solution than the current system of paying for retirement as the baby boom generation -- those born between 1946 and 1964 -- leaves the workforce.

"The money has to come from somewhere," says Stephen Stanley, chief economist at RBC Greenwich Capital in Greenwich, Connecticut, who was also included in the survey. "Under the current system, we save nothing, which means we are on the hook for all the necessary payments in the future. Under personal accounts, people are saving a part of their eventual retirement income. Whether investment returns and the economy are good or poor, the burden will be spread out over time."

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Last Updated: March 28, 2005 00:33 EST

Bruce

From: Rep. Bruce Weyhrauch [Representative_Bruce_Weyhrauch@legis.state.ak.us]
Sent: Thursday, June 23, 2005 8:57 AM
To: Bruce Weyhrauch
Subject: FW: The Economist, :(reading

From: Brad Fluetsch [mailto:bjf@gci.net]
Sent: Tuesday, June 21, 2005 4:30 PM
To: Rep. Bruce Weyhrauch; Rep. Beth Kerttula; Sen. Kim Elton
Subject: The Economist, :(reading

Buttonwood

S&L redux

Jun 21st 2005
From The Economist Global Agenda

Who should be responsible for honouring the promises that companies make to their workers?



BUTTONWOOD is not exactly counting the grey hairs yet. But in the unlikely event that her children ever finish their hugely expensive education, it would be nice to think that she could hang up her keyboard one day and devote herself to Sudokus. The way company pension funds are going—and *The Economist's* is better than most—that day looks increasingly remote.

It's not just the headline problem-kids—MG Rover, the British carmaker that went bust this year stranding 5,000 workers; America's United Airlines, which tossed its 120,000 workers at the Pension Benefit Guaranty Corporation (PBGC) in May and ran, in the biggest pension default in history; or General Motors, borrowing to pay the pensions of workers as it fights for its life. The issue is broader.

Pension plans depend on company contributions and investment returns for their funding. Actuaries' assessments of mortality rates give a guide to future liabilities. Bond yields provide the discount rate that broadly determines what current assets the plans must hold in order to meet those liabilities. The situation has been dire all round. Returns on investment have been lower than expected. Bond yields have been too, thus swelling the amount of current assets plans must hold.

Beneficiaries are living longer than anyone thought they would.

True, companies could have spent more of their recent record profits topping up their pension plans and less of them pleasing shareholders with dividend increases and share buybacks. But they have at least been paying more in. Employer contributions have shot up in Britain; last year, for example, firms contributed £25.6 billion (\$47 billion), compared with £20.9 billion the previous year, and a steady level of around £7 billion in the 1990s (almost all of the money goes to defined-benefit schemes). The trouble is that liabilities have shot up faster.

In Britain, defined-benefit pension funds of FTSE 350 firms were around £70 billion short of where new international accounting standards say they should have been at the end of May, on figures from Watson Wyatt, a firm of actuaries. A broader definition of full funding puts the shortfall at £197 billion. Pension legislation enacted in 2003 and 2004 has broadly tightened funding, but these baked-in deficits are huge and so is the anxiety they generate. The only worry that is not yet on many lips is that taxpayers might have to underwrite the Pension Protection Fund if too many pension schemes go into default.

Not so in America, where people are speaking openly of a taxpayer bail-out to rival the rescue of America's savings-and-loan (S&L) sector in the late 1980s. The pensions insured with the PBGC showed a shortfall of almost \$354 billion at the end of the last fiscal year, compared with \$279 billion a year earlier. If the deficits of less underfunded plans are rolled in, the total shortfall is more than \$450 billion. The PBGC had a \$23.3 billion deficit last year in its main programme. Premiums do not keep pace with expected claims, still less reduce the accumulated shortfall. An independent think-tank, the Centre on Federal Financial Institutions (COFFI), said this week that the PBGC needs an infusion of \$92 billion in today's dollars to meet its future obligations.

And the problem can only get worse. America's defined-benefit schemes tend to be more concentrated than Britain's in the unionised and industrial sectors that have been most buffeted by competition of one sort or another lately. Delta Airlines threatens to follow US Airways and United Airlines into bankruptcy and pension default. Ford, GM and DaimlerChrysler have among them hundreds of thousands of pensionable employees and retired workers. More generally, the number of those receiving benefits is increasing, while the number of active workers in defined-benefit schemes is falling. This adds to the pressure.

Companies and asset managers have tended to take a laid-back approach to pension underfunding, relying on the markets to right things as they often have before. What is worrying about the latest numbers is that we are seeing them towards the end of a period of strong economic growth and corporate profitability, neither of which is likely to continue. John Mauldin, an investment consultant, calculated in a recent column that total portfolio returns over the next ten years were likely to be around 5%, far less than the 8-9% projected by most funds. He reckoned that the total shortfall in America could be somewhere between \$500 billion and \$750 billion. And that is without counting companies' promises to provide health care to employees and retired workers. Nicholas Colas at Rochdale Research, an independent firm, calls these obligations a bigger problem than pensions because they are neither funded nor insured.

There are a couple of weird circularities here. Most of the burden of filling these gaps will fall on the companies themselves, which will depress their profits. That, in turn, will depress share prices, which will make it harder to achieve adequate investment returns. And if asset managers turn en masse to bonds with long maturities to match their assets and liabilities more precisely, which is necessary especially for older plans, that will raise bond prices, depress bond yields and increase the present value of assets they must hold—again, widening the pensions gap. They could, of

What is worrying about the latest numbers is that we are seeing them towards the end of a period of strong economic growth and corporate profitability, neither of which is likely to continue

course, look to other asset classes that pay higher or "absolute" returns (hedge funds of funds, private equity, property) and many are doing so. But "alternative" assets do not typically account for more than one-tenth of the total portfolio, in part because they are labour-intensive to manage.

This is all looking dark, if not necessarily as bad as the S&L meltdown, which cost taxpayers \$128 billion. It is especially bleak because it is forcing societies to establish difficult priorities. These "legacy costs" are, in a sense, the debt that the new economy owes the old one. But no one wants to pay it.

Should workers just be forced to accept the bad hand that fate dealt them? That looks rash as well as unfair: in America, the workers who would be thus left to their own devices fall disproportionately in swing electoral states such as Michigan, Ohio and Florida. Should a company's current shareholders bear the brunt? If so, more firms than ever will close their defined-benefit schemes (in America, only about a fifth of all workers are covered by one now) and the investment risk inherent in saving for retirement will fall on the untrained individual. Or the taxpayer could foot the bill—but both America and Britain (indeed, most governments in most places) are printing money as it is. As COFFI's Douglas Elliott says, "All the choices are ugly."

Send comments on this article to Buttonwood (Please state whether you are happy for your comments to be published)

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PV=(I-C)(i)^2+L*(i^2)^2+A*i
bjf

Ginny Austerman

From: Bruce Weyhrauch [whyrock@gci.net]
Sent: Monday, July 25, 2005 11:48 PM
To: Ginny Austerman
Subject: *****SPAM***** FW: New Jersey pension problems

file

From: Brad Fluetsch [mailto:bjf@gci.net]
Sent: Monday, July 25, 2005 5:41 AM
To: 'Bruce Weyhrauch'
Subject: New Jersey pension problems

N.J. taxpayers face a pension bill of \$383 million

Saturday, July 23, 2005
BY DUNSTAN McNICHOL
Star-Ledger Staff

Pension costs for municipal workers, police and firefighters have more than doubled this year, leaving local taxpayers facing a bill of \$383 million in budgets that will be drawn up early next year, state officials announced yesterday.

"Quite frankly, they took my breath away," Bill Dressel, executive director of the New Jersey State League of Municipalities, said of the new pension costs, which were announced late yesterday. "These are astronomical increases."

State Treasury officials said the new pension bills -- an increase of \$208 million over the amount local taxpayers had to pay this year -- would have been far higher except for a policy of phasing in the retirement costs over five years.

"But for the phase-in, taxpayers would have felt a much more significant impact," said Treasury spokesman Tom Vincz. "We provided as much notice as possible for them (local officials) to make plans."

The new pension payments are due from towns next April. They will have to be included in municipal budgets next year, a fact Dressel said will likely lead to local property tax hikes.

"The magnitude of the increases and the fact we have gotten no state aid increases this year magnifies the problem," said Dressel. "I think this is going to be a shocker."

For local government officials, the pension bills are a relatively new entry on their balance sheets. Before this year, local governments had gone six years without having to pay anything toward their employees' retirement programs. Instead, state financing maneuvers and a soaring stock market had generated surpluses that offset the need for new contributions.

But that changed dramatically with the collapse of the stock market in 2002. State Treasurer John McCormac told lawmakers during budget hearings this spring that the state and local retirement systems are now underfunded by as much as \$35 billion -- a deficit that must be made up by investment gains or contributions over the next three decades.

For local governments that means the cost of pensions is suddenly becoming a big-ticket budget item.

In Newark, for instance, the bill for pensions will jump from \$9.6 million this year to \$20.2 million. West Orange, the hometown of acting Gov. Richard Codey, will owe \$1.9 million in pension payments next year -- \$1 million more than the township paid this year.

Statewide, the bill for pension contributions that local taxpayers must fund has jumped from \$175 million this year to \$383 million for next year. And that is only the start of a trend.

Under the state's phase-in program, towns have been billed only 40 percent of the actual tab they owe for their non-uniformed public employees and 60 percent of what is due for the police and firefighters' system. In upcoming years the portion billed is scheduled to rise by 20 percent annually, and because of lower than projected investment gains, the total bill is also on track to keep growing.

"It's absolutely clear to me that I'm going to have to think of some way to soften the impact of these costs between now and April," Dressel said.

$$PV = (I \cdot C)(i)^2 + L \cdot (i^2)^2 + A \cdot i$$

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Voice of the Times

A CONSERVATIVE VOICE FOR ALASKANS

WILLIAM J. TOBIN
Senior editor

PERS/TRS reform becomes reality

By **RAYMOND MATIASHOWSKI**

Shortly after Gov. Frank H. Murkowski took office in 2002, we learned that we had inherited a Public Employees' Retirement System and Teachers' Retirement System that had an unfunded pension liability of more than \$4 billion. Today the underfunding stands at \$5.7 billion.

We went to work and Gov. Murkowski is about to sign landmark legislation implementing much-needed PERS/TRS reform. The measure originated in the Alaska State Senate and passed during the special legislative session.

PERS and TRS reform fully protects the existing retirement benefits for all current and retired state employees. Nothing changes for Alaska's current public sector workers or teachers.

For employees hired after July 1, 2006, the reform measure replaces the existing defined benefit plan familiar to state workers with a new defined contribution plan similar to the 401(k) plans used by federal and many private sector employers.

The defined contribution plan provides comprehensive retirement benefits for future state employees and is a recruiting tool for the professionals we depend on for effective state government.

Gov. Murkowski will make history when he adds his signature to PERS and TRS reform. The measure recognizes flaws in a system that was increasingly unstable financially and losing the ability to meet the needs and expectations of employees and employers.

To deny that Alaska's pension plan was troubled and more than \$5 billion-plus underfunded was to ignore reality. And make no mistake, the state has a constitutional obligation to make sure pension benefits earned under the existing system are paid.

First it was urgent that we stop the hemorrhaging of red ink. Now policymakers can move on to craft a solution that will address the unfunded liability. We will continue to work closely with the Legislature, including the House Special Committee on Ways and Means



that is holding a series of meetings and hearings during the interim until the next session convenes on January 9.

Today, America is a nation of constant change and movement. Location and lifestyle changes are the norm rather than the exception. Research indicates that young workers entering the workforce recognize that the defined contribution is an attractive plan.

If a young family is thinking of moving north for work in Alaska, the new defined contribution offers more flexibility than the dated defined benefit program.

For a future state employee, the employer and employee will make contributions totaling 13 percent of his or her paycheck into the defined contribution plan. In addition, the employer and employee will set aside a combined 12.26 percent of the employee's wages into the supplemental benefits annuity plan.

Together, these two plans — comprising employer and employee contributions — will represent a total of 25.26 percent of an employee's payroll for future retirement benefits.

Like a 401(k) plan, the defined contribution is portable with many employers when jobs or careers change. Benefits are protected for employees and families and throughout careers.

PERS and TRS reform stabilizes the system and reduces financial volatility

with a new Alaska Retirement Management Board. ARMB members take up their duties on Oct. 1 of this year.

The new board combines the functions of separate boards for PERS, TRS and the Alaska State Pension Investment Board that were responsible for \$12 billion in pension investments. Under the former structure, one board dealt exclusively with the assets while the other two boards were responsible for the liabilities of the retirement systems.

This created an inherent disconnect. The new board resolves this problem by making one board responsible for both assets and liabilities.

A common question during the PERS and TRS reform debate was, "Can't we just wait and get another opinion?"

Until recently, General Motors may have thought it could "just wait." But now GM has said it must lay off 25,000 workers. Standard & Poor's had downgraded some GM debt to junk bond status, worker pensions were underfunded and health care costs were out of control.

Alaska will not "just wait." We will not let our state be vulnerable to billion-dollar liabilities that put taxpayers at risk of massive tax increases.

Raymond Matiasowski is commissioner of the Alaska Department of Administration.

The Anchorage Times

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Vermont Probes Near-Universal Problem of Underfunded Pensions

Posted 07/26/05

By Helen Chang

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A special commission of Vermont officials met for the first time this week to tackle a problem that, according to one study, afflicts 94% of all public pension programs: underfunded liabilities.

Vermont Treasurer Jeb Spaulding said the retirement systems his office manages —

the state, municipal, and teachers pension systems that altogether have 24,027 active and 9,318 retired members — are ripe candidates for reform. Even as the costs of retirement plans and post-employment benefits soar, state and local governments are pressed to match pension demands with tax dollars and investments that failed to perform to expectations. It's a problem with no clear or easy solutions.

"Without the study, it will be much harder to find the political will necessary to make changes," Spaulding said. "Our funding status isn't anywhere near what people think it is, so I'm anticipating this will be an interesting exercise."

Vermont will be reviewing its pension benefits and how they compare to other public retirement systems, and whether they are consistent with the state's demographic trends. Spaulding said he would also consider new options for paying for pensions, including requiring local

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government contributions, selling pension obligation bonds, or re-amortizing the pension systems' unfunded liability.

Vermont may discover, as other states have, that it owes retirees more than expected.

Rhode Island, for example, earlier this month decided to reduce pensions for future and existing public employees. Lawmakers there reduced some state employee and teachers retirement benefits after a pension review committee's report "opened their eyes to the huge costs they'd be hit with if nothing changed," one state official said. Rhode Island's unfunded pension liability for state workers and teachers is estimated at \$3.5 billion — more than half its \$6.35 billion annual budget.

Officials say the reforms, which only apply to state employees and teachers with less than 10 years of service, will immediately save the Rhode Island and its local governments \$44 million this year and \$270 million over the next five years. Rhode Island's local governments contribute 60% towards the teachers pension system.

For the first time since 1984, Rhode Island lawmakers established a minimum retirement age. Cost of living increases, previously set at 3%, are now pegged to inflation with a 3% ceiling. Benefit levels were also reduced. Current retirees with more than 35 years of service now receive 80% of their base salary. New retirees can now expect 75% after 38 years of service.

Not surprisingly, the move has elicited criticism.

"It's a terrible outcome and well beyond what we think is fair," said Bob Walsh, executive director of the National Education Association of Rhode Island. "A teacher coming in under the new system, and paying 9.5% salary contribution over 38 years to maximize benefits, will have paid the entire pension benefit themselves [by the time they retire]."

Standard & Poor's analyst Parry Young estimates Rhode Island is only the second state to reduce its pension benefits, after Oregon. Unfunded pension liabilities are also squeezing states and localities' budgets elsewhere in the Northeast, rating agencies said. Connecticut, which faced a \$1.1 billion budget gap this year, has a \$12

billion unfunded liability from its state employees and teachers retirements systems, according to Fitch Ratings. Massachusetts' unfunded liability is similarly sized, according to Standard & Poor's.

In a nationwide survey of 109 state retirement systems, investment management and consulting firm Wilshire Associates Inc. found that 94% are underfunded, though funding ratios have improved alongside recent gains in the stock market.

Despite the apparently broad reach of the problem, few states so far have undertaken structural pension reforms. Reform is often a politically sticky affair as public officials must balance their fiduciary responsibilities with retirees' demands, which are often backed by politically strong unions. Oregon, which also sold pension obligation bonds to reduce its liabilities, emerged from a two-year legal battle with public employee unions last month when its state Supreme Court upheld many of the structural changes lawmakers made to the pension system in 2003, according to pension spokesman David Crosley.

Rhode Island's reforms follow a 77-page report and a year-long study by a pension review committee created by Republican Gov. Donald Carcieri in 2003. All 12 committee members, six representing labor interests and the others the administration and local management, agreed that reform was necessary, though only half approved the report's recommendations, said committee chairman Jerome Williams, who also serves as the executive director of the state's Department of Administration.

While Rhode Island requires employees to pay some of the highest contributions to their pensions in the country, the benefits paid out were generous when compared to other systems. Rhode Island's pensions offered a 3% annual cost of living increases, adjustments found in only 16% of other plans surveyed. The retirement system lacked a minimum retirement age, which encouraged workers to retire earlier. The average retirement age for teachers in 1993, for example, was 60. Now it's 56.

Demographic trends were also found to increase pressure on pension systems as retirees are proportionally growing faster than active workers. In Rhode Island's teachers system, which has 14,710 active and 7,310 retired members, retirees are increasing at 5.7% compared to

active members' 2.9%. In the state workers system, with 13,795 active and 9,426 retired members, active members are growing at 1%, compared to 1.5% for retirees.

Pension committee members had briefly considered issuing POBs, but were daunted by the size of a potentially \$500 million issue. Last year, the state roughly had \$720 million of outstanding GO debt.

"It just wasn't feasible," Williams said. "One of the things we pride ourselves in is our credit rating, and we didn't want to impact our ability to issue debt in the future."

Additionally, POBs haven't always worked out as intended. The bonds reduce management's flexibility, in that it turns the unfunded liability "soft debt" into "hard debt." POBs are also a gamble because the investment proceeds from the bonds may not yield more than the bonds' original interest rate. Pension system officials considering such a tack should consider Worcester, Mass.

Worcester has incurred a significant additional liability on its roughly \$220 million of POBs sold in 1998, due to lower than expected investment returns. The POBs now represent 34.5% of the city's outstanding debt, according to Moody's.

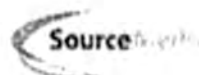
Worcester's retirement system became fully funded after its bond sale. However, the retirement system's unfunded pension liability has now grown to \$160 million, thanks to poor stock market investment returns and expanded retiree benefits, according to the Worcester Regional Research Bureau.

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Magazine

Their Own Worst Enemy

Why are so many public plans in trouble?

Their Own Worst Enemy

Why are so many public plans in trouble?

"I do not know if we invented the process of skipping out on pension obligations, but we sure perfected it," says Ralph Martire about the state of Illinois and its politicians. "We are the masters of the politically expedient."

State law requires balancing the budget each year, and Illinois legislators have a perennial problem because the state has not broadened its revenue base enough, says Martire, executive director of The Center for Tax and Budget Accountability, a bipartisan think tank based in Chicago. "The alternatives are that they can raise taxes or raid the pension funds again. So, they dip into the pension funds to avoid painful spending cuts," he says. "This year, they did not fund the pension contribution at all. It saved them \$2.4 billion."

The consequence, according to Martire: "We have the biggest pension underfunding of any state in the nation. It is \$38 billion and growing. We have a bigger unfunded obligation than New York, Texas, Florida, or California. It is outrageous. This is not a partisan problem: Republicans and Democrats are equally culpable of resorting to feckless measures to balance the books, and their failure is haunting us now."

Public pension funds had an aggregate funding ratio of 88.2% in fiscal 2004, says Keith Brainard, Austin, Texas-based research director for the National Association of State Retirement Administrators. That number, which includes primarily state funds but also some local funds, compares with 101% in fiscal 2001. "[The current funding ratio] is going to be right about the low point, assuming investment returns stay in their normal range," he speculates.

Moreover, the official numbers may underestimate the depth of the problem, according to a study by Barclays Global Investors. If public plans used the same accounting rules as private plans, their underfunding would total about \$560 billion rather than the reported \$278 billion, the study found. The reason: FAS 87 stipulates that private plans use different rates for the assumed investment return and the discount rate for calculating liabilities, while Government Accounting Standards Board regulations mandate that public plans utilize the same interest rate for both, says Matthew Scanlan, a San Francisco-based managing director at BGI. As he says, "It has a huge effect."

There has been lots of talk about how poor stock market returns and low interest rates led to problems for pension plans. However, there has been less light shed on another major contributor to the dilemmas faced by public plans: politicians.

"The funding mechanism is controlled by politics," says Fred Nesbitt, executive director and legislative counsel at the National Conference on Public Employee Retirement Systems in Washington. "If politicians increase the benefits but do not increase the funding, that is going to catch up with them. If they are enjoying pension 'holidays,' they should not be surprised if they have to contribute more later. In California, where Governor Terminator is saying, 'Oh, it is costing us too much money,' he forgets to mention the five years when employers and taxpayers did not have to make a contribution."

Still, most public plans are in OK shape, Nesbitt believes. Where big problems exist, he says, "It is not because the trustees are irresponsible. It is not because defined benefit plans do not work. It is because people manipulate the plans for political purposes—and it is coming back to haunt us."

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Low Contributions + High Benefits = Trouble

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Public plans' current troubles often boil down to too-low contributions or too-high benefit increases—or both. Politicians have a lot of influence on each.

The stock market's boom got politicians addicted to scant contributions. "[They] quickly got accustomed to low contributions, or no contributions," Brainard says. In states like New York and California, he adds, employer contribution rates drifted down to "near zero and, in some cases, zero."

ERISA governs contribution levels for private plans, but those rules do not apply in the public sector, says Steven Foresti, managing director at Wilshire Associates Inc. in Santa Monica, California. "For public plans, it depends state by state, municipality by municipality," he says. "The guidelines in terms of contributions are vastly different."

The market's boom led to another ill-fated move for many public plans. "Suddenly, funding the future commitments seemed a lot less expensive. So, there was pressure to increase benefits," Foresti says. After all, public-employee unions form a powerful voting block.

"Benefits were increased at a time when assets were at a high," Foresti says. "All it takes is a downturn in the markets to reveal the true costs of funding these benefits." Politicians sometimes increased pension benefits with a philosophy of "We will pay for that later," Scanlan says. "Pension plans have overpromised benefits—and a lot of those pension promises are coming due."

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Four Places Where It Happened

Four Places Where It Happened

A bunch of state and local plans have found themselves needing to put up big contribution bucks. Brainard puts it simply: "The bottom fell out of the market. So, contributions have leaped." Here are four of those stories:

New Jersey. The \$70 billion New Jersey Public Employees' Retirement System (PERS) faces serious trouble. "[The plan's underfunding] is about \$25 billion," New Jersey State Treasurer John McCormac says. "Depending on the assumptions you use, it could be as high as \$30 billion."

The trouble largely stems from the 1997 decision by then-governor Christie Whitman to float \$2.8 billion in 30-year bonds to pay off the state's underfunded pension. The idea: that the state could use the proceeds to earn more in the then-hot stock market than the 7.64% it had to pay out in interest on the bonds.

"The plan was that it would wipe out pension contributions for the foreseeable future," McCormac says. "It is essentially a 30-year bet that you can earn more on the pension investments than the yield on the bonds."

That worked well for a few years, until the stock market tanked. Now, the state not only owes

the principle and interest on the bonds, but also faces big funding payments into the pension system.

"We still owe \$10 billion in principle and interest on those bonds," McCormac says. The actuary for the state's six pension systems estimates that the state will have to contribute \$1 billion to the plans in 2007, he says.

- Why would anyone make such a risky move? Whitman was running for reelection at the time, and wanted to cut taxes rather than use the money to fund the pension. Asked if he thinks that politics motivated the decision, McCormac says, "You draw your own conclusions." Nesbitt puts it more bluntly, saying, "The pension system there has been robbed."

Now, New Jersey has to try to dig out. The solutions include diversifying its investments more, McCormac says. PERS has not been meeting its annual assumed return, he says, which was 8.75% until it was lowered to 8.25% earlier this year.

The retirement system invests two-thirds of its money in stocks and one-third in bonds, he says, while "every other major plan in the country has alternative investments."

New Jersey has taken criticism in the past for some archaic policies, including not hiring any outside managers and only trading on Tuesdays. The Tuesday mandate is history now. The investment diversification project started in June, and the Investment Council approved the first three investments in private equity. These investments cannot be managed in-house by the Division of Investment staff, a Treasury spokesperson says.

In May, acting New Jersey Governor Richard Codey named an eight-member Benefits Review Task Force to recommend ways to deal with the escalating cost of the state's benefit programs. McCormac will not comment on the possible retirement plan changes, but sources say that they could include converting new employees to a defined contribution plan going forward.

San Diego. The San Diego City Employees' Retirement System faces a \$1.4 billion deficit, and Mayor Dick Murphy announced his resignation earlier this year as the criticism mounted. Tensions are running high at the City by the Sea, where the Securities and Exchange Commission has issued subpoenas, and the District Attorney has filed criminal charges against seven pension board members for their role in boosting pension benefits (including their own). A handful of city retirees has even filed suit against the city's pension actuary for his alleged role in obfuscating the impact of changes in the pension program.

"The problem is not public employees," says Steven Erie, a professor of political science at the University of California, San Diego, and a long-time watcher of the city's political scene. "The real problem in San Diego is cheap voters and cowardly politicians."

The trouble started a while back, Erie says, when the city failed to diversify its revenue sources enough after state voters, in 1978, approved the Proposition 13 initiative limiting property tax rates. "The last 20 years, we should have had an honest discussion about raising taxes and revenues," he says.

So, city politicians siphoned off pension surpluses during the 1990s to the city's general revenue fund, Erie says, on the rationale that the booming stock market meant that the fund did not require more than the minimum contribution. "San Diego put all its eggs in one basket: the pension," he says. "This was the goose that laid the golden egg."

During that same time, Erie says, local politicians also increased public workers' retirement benefits. "Because of the political culture in San Diego, we do not give employees much in the way of salary increases," Erie says. In May, Murphy announced a three-year labor deal with the San Diego Municipal Employees Association that calls for a salary freeze during the first two years and a 4% salary boost during the third year. "We backload it with pension increases, so that it does not show up in the budget today. It is a classic strategy"—a

strategy that increased the pension plan's liabilities.

Given those political decisions, Erie says, it is no surprise that the finances of the city and its pension fund went south when the stock market did. "The chickens," he says, "have come home to roost."

Houston. Like San Diego, Houston made a dubious boom-time decision to raise city employees' retirement benefits. The Houston Municipal Employees Pension System went from 91% funded in 2000 to 60% funded in 2002. "It was a function of benefit enhancements," says Joseph Esuchanko, an actuarial consultant hired by the city administration to study the problem.

In 1998, the city had set up a deferred retirement option plan (DROP) within its defined benefit plan that let city employees take retirement when they were eligible but stay on the job. Under this option, an employee's monthly retirement, earned as of the effective date of DROP participation, is credited to his DROP account. While the employee continues to work, he or she earns no additional retirement credits. However, his DROP account is credited with the contributions he would otherwise make to the pension plan, interest at a minimum rate of 8.5% (compounded daily), and an annual 4% cost of living adjustment. The pension the DROP participant receives, over and above his DROP account when he retires, is sometimes greater than what he would have received if he had not participated in the DROP.

Between 1993 and 2001, the city thrice raised the accrual percentage for calculating benefits. During that time, for instance, the percentage for those with 25 years of service jumped from 52.5% to 88.75%. This was a 69% increase in pension, compared to a 23% increase in the Consumer Price Index during that time.

The plan's actuary initially made assumptions about the DROP that proved too upbeat, says Esuchanko, president of Troy, Michigan-based Actuarial Service Co. In 2001, the plan's actuary continued to assume limited participation in the DROP, based on past experience, even though the incentive for participating in the DROP had increased substantially. "If the actuary uses extremely optimistic assumptions, it appears that the cost will be significantly less than it actually will be," he says.

Not surprisingly, then, the new setup could lead to some big benefits. Esuchanko's study included what he calls a "worst-case scenario." Say a 46-year-old Houston city employee hired at age 22 and making \$40,000 annually had taken the DROP option. If that person continued working for the city until age 65, the DROP account would have grown at 11.1% interest to a staggering \$2.75 million. "This person would have a replacement ratio at retirement of 455%," he adds.

In 2000, the study says, the city's contribution to its pension plan totaled 9.5% of member payroll. Two years later, the number had grown to 31.8%. By that time, the unfunded liability had skyrocketed from \$133 million in 2000 to \$995 million, Esuchanko says. Last year, the city's voters approved a measure that excused the city from a state law preventing reductions in the pensions of city employees. Subsequently, changes were made that returned the pension formula to pre-2001 rates and removed many of the DROP incentives. Those changes substantially reduced the financial burden on taxpayers, he says.

Alaska. In the case of the state of Alaska, legislators rather than voters decided to make a change prompted by a pension cash crunch. This May, they voted to put all new state and local government hires as of July 2006 into a defined contribution plan. The reason: a \$5.7 billion total funding shortfall in the Alaska Public Employees' Retirement System (PERS) and the Teachers' Retirement System (TRS).

The financial crunch stems from two factors, says Esuchanko, who was hired by a state legislative committee to study the situation. First, the state's pension funds had poor investment returns- as the stock market turned unpredictable. Second, Alaska takes the

unusual step of pre-funding its post-employment health care through the pension plan; that policy cannot be changed because a state law prohibits taking away any future benefits promised to state workers, he says. "With the rising cost of health care, the liability has grown astronomically," he adds.

Not everybody thinks the defined benefit plans were hopeless. The Alaska legislature's switch to a defined contribution was "purely political," Nesbitt believes. "The pension funds had a \$5 billion shortfall, and they used that as a way of destroying the pension funds. They will live to regret it, because they will have a problem with hiring and retaining state employees."

Esuchanko does not paint such a dire picture, but he agrees that the move does not make the state's problem disappear. "Certainly not in the short term, because they have got all these people in the defined benefit plan," he says, "and, five years from now, the vast majority of employees will still be in the defined plan."

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SIDEBAR: Out of Control?

GASB shift could mean trouble for government health-care programs

The sound of distant thunder heard today at many city and state government offices is not coming from a summer storm. Instead, it is coming from the Norwalk, Connecticut based Government Accounting Standards Board as the deadline nears for the enactment of Statements 43 and 45.

Back in February 2003, GASB officials decided it was time for state and local governments to join their corporate brethren and report the accrued liabilities for what are referred to as "other post employment benefits" or OPEB. As most of these benefits are ever increasing retiree health-care costs, the added burden of reporting them as they are accrued rather than the long-time, "pay-as-you-go" method could deliver a blow to municipalities. To quote one city official, "It would take our credit rating and flush it down the toilet."

How many municipalities will the GASB changes affect? According to the International City/County Management Association Retirement Corporation (ICMA-RC), 60% of city and county governments provide health-care benefits to retirees. Of those, about one-third pay 100% of benefits; one-third share the cost with retirees, and another third are entirely retiree-funded. Adding to the burden on employers—and retirees—is the continuing escalation in the cost of these benefits. ICMA-RC found that, in 2003, the average cost to insure an individual was 62.5% higher than it had been in 1998. Local governments are going to have to be creative in planning to account for the full cost of accrued retiree health benefits or risk jeopardizing their bond credit rating.

Officials in Orem, Utah, are well along in planning for the change. Back in 1982, city employees were given a retiree health-benefit plan in which the city paid 75% of the premium for eligible retired employees and their dependents, with single or family coverage. Orem, with a population of 90,000, currently has 420 benefit-eligible employees and 51 retirees receiving retiree health-care coverage. However, "If everyone retired who could, the group of 51 would become 125 retired and their dependents," notes Assistant Deputy City Manager Richard Manning.

"The change to GASB caught a lot of people by surprise," he believes, and city officials quickly turned to the Salt Lake City office of Milliman (USA) Associates for an actuarial study of the retiree health plan. The study revealed that, as of January 1, 2004, the city needed to put \$14.8 million in a trust account and add \$800,000 more each year to get the plan fully funded—not likely with an annual city budget of \$60 million.

"For the past eight months, we have been devising an exit strategy for our defined benefit

health-care plan," Manning continues. In 10 separate meetings—with city council members, employees, and retirees—Orem officials, working with their health-plan provider, ICMA-RC, worked on a transition plan. Although the plan has not yet been officially adopted—the city has until July 1, 2007, to begin complying with the new GASB rules, after all—the basic outline has been reached. For the next 15 years, through 2020, the city will move away from the current 75% premium payment defined benefit while allocating a block of money to pay for that premium each year to eventually fund the current commitment. Next year \$280,000 will be set aside. The 15-year phaseout will feature an annual allocation for funding to be distributed to qualified retired employees to assist them in paying their health-care premiums.

Just as the trend in pensions has been a migration from defined benefit to defined contribution, Orem is setting up its own version of a consumer-directed health-care (CDHC) plan called the Retiree Health Savings Plan. Beginning in 2006, current employees will contribute to the plan with a salary deferral that the city capped at 5% of pay. Participants select investment options such as mutual funds. Contributions, earnings, and distributions are tax-exempt for both the participant and the city. Another new benefit is an unused sick leave buy-back. Employees can have slightly more than 1% of annual salary donated to the plan for them each year that they do not use their sick leave. If they do use some of it, then 25% of the current year's unused sick leave can be donated to the health savings account.

The advent of accrual accounting for retiree health benefits does not bode well for defined benefit health plans at government employers. Back in 1990, the Financial Accounting Standards Board (FASB), which oversees the corporate world, issued FAS No. 106 requiring private employers to account for OPEB. Notes Kathy Harm, director of retiree health at ICMA-RC, "[That reporting requirement] is, in part, responsible for the significant drop in the availability of employer provided retiree health care in the private sector." In 1988, 66% of firms with more than 200 workers provided some health-care benefits to retirees. By 2002, the number had dropped to 34%, and that does not take into account reductions in coverage among that 34%.

GASB 45 will go into effect at various time intervals, depending on fiscal year and size of the employer, beginning after December 15, 2006. Many employers will not be affected until July 1, 2007. "While the actuarial liabilities associated with governmental retiree health benefits are significant, it's important to understand that the employer's financial statement liability (i.e., the 'net OPEB obligation') will accumulate gradually over time as the difference between annually required OPEB contributions and contributions actually made materializes," explains Brian Murphy, senior actuary and president of Gabriel, Roeder, Smith & Company. "Governmental employers have time to consider how they will deal with the issue," he believes.

Whether or not there will be an effect on the employer's credit rating remains to be seen, Murphy continues, but initially, at least, implementation of GASB's OPEB rules will affect many governments in a similar manner. Benefit changes are likely and, in some cases, already are under way. It is difficult to determine how this will evolve, but it will likely involve additional costs borne by the participants and some movement toward defined contribution-type plans, like health savings accounts, for retiree health care. The extent to which these types of plans will become substitutes for traditional health-care coverage is unclear, Murphy concludes.

Employers that historically avoided a defined benefit health plan are in better shape to handle the GASB ruling. One such sponsor is Steve Purvis, director of special projects and internal audit for the city of Boise, Idaho. "We decided we should stay away from providing defined benefit-type health coverage for our employees, other than the Public Employee Retirement System of Idaho," Purvis explains. "We made the decision early on [in the early 1990s]. Looking at the numbers had to scare a finance guy to death," he gibes.

While the fire and police unions fought a hard battle for a defined benefit health plan, Purvis researched alternatives. He wanted to accomplish three things: get employees to save

money; make the money "do more" by allowing employees to select how they want to use the money in their accounts; and make participants more efficient users of the money. He also was looking for a more flexible plan than a defined benefit would allow. It turned out that Nationwide Financial's Post-Employment Health Plan (PEHP) fit their requirements.

Boise is a city with a population of close to 200,000, and has a full-time work force of approximately 1,500 employees, with 1,419 participating in the PEHP and 106 who have either retired or separated from service, and are receiving disbursements from the program.

The purchasing power of the participants was increased due to the fact that the funds going into the PEHP, accumulating, and coming out of the plan are tax exempt as long as they are used for qualified IRS medical expenses. One of the advantages of the PEHP design that is not talked about very much, Purvis feels, is the flexibility that it provides to participants as they use the funds. The participant gets to decide when the funds are used, how much are used, and on which IRS-qualified medical expenses they will be used.

As with other HRAs, the PEHP has been tailored to meet the city's needs. "We tried to design formulas that would allow more people to reach the minimum funding status of \$44,500," says Purvis. The standard is an attempt to provide sufficient funds to pay 15 years of single person premiums to cover the gap between normal police and fire retirement at around age 52 to 54 and Medicare integration. To meet the funding objective, several existing benefit programs were restructured. For example, a part—one-third—of the employer- 4.5% deferred compensation 457 plan match was redirected to the PEHP. The sick leave conversion benefit plan also was restructured and the funds put into the PEHP. The objective was to find various ways to provide funding for post-retirement medical costs. As medical costs continue to rise, the funding formulas need to be reviewed and adjusted.

An added benefit of restructuring the sick leave conversion plan was that, by automatically "sweeping" money out of the sick leave account and monetizing accumulated sick leave hours over a stated level annually rather than at retirement, employees felt an immediacy to the benefit, and sick leave utilization was reduced.

When it comes to complying- with GASB 43 and 45, Purvis notes that, while the police and fire retirees pay 100% of the active employee premium upon retirement, there will be some effect because the police and fire employees stay in the active employee medical plan from retirement until their Medicare integration dates, or around 10 to 12 years, a cost that is subsidized by the city and the active employees due to higher claims costs for retirees. Still, the effects will be mild compared to municipalities with defined benefit retiree health plans, notes Purvis.

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PERS and TRS Funding
Response to Questions
Alaska House of Representatives
Special Committee on
Ways and Means

Presented by
Department of Administration
Division of Retirement and Benefits

September 8, 2005

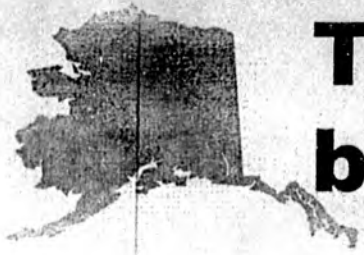


Questions posed from June 15, 2005, letter received from Representative Weyhrauch. With respect to PERS and TRS, how are Tier I, II, and Tier III contributing to the deficit?



PERS 6/30/04 Accrued Liability by Tier (000's)

		<u>Accrued Liability¹</u>	<u>Percentage</u>
Tier I	\$	9,000,000	79.0%
Tier II	\$	2,000,000	17.5%
Tier III	\$	400,000	3.5%
Total	\$	11,400,000	100.0%



TRS 6/30/04 Accrued Liability by Tier (000's)

		<u>Accrued Liability²</u>	<u>Percentage</u>
Tier I	\$	5,550,000	90%
Tier II	\$	600,000	10%
Total	\$	6,150,000	100%

State of Alaska

DEPARTMENT OF ADMINISTRATION

DIVISION OF RETIREMENT AND BENEFITS

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September 7, 2005

The Honorable Bruce Weyhrauch
Chair Special Committee on Ways and Means
House of Representatives
State Capitol, Room 421
Juneau, AK 99801

Re: Response to Questions for September 8, 2005, Meeting

Dear Representative Weyhrauch:

This letter is written in response to the questions received from you on September 6, 2005. I have re-stated your questions below in italics with my responses immediately following.

1. *What is the present amount of the unfunded liability for PERS and TRS?*

The draft valuation as of June 30, 2004, indicates the unfunded accrued liability for PERS is \$3.4 billion and \$2.3 billion for TRS. The total unfunded liability for both retirement systems is currently estimated at \$5.7 billion. The next actuarial valuations for the systems using data as of June 30, 2005, will be available in April 2006.

2. *When we say unfunded liability what does that mean and is that different from using the words "deficit," "indebtedness," or "debt?"*

The "unfunded liability" is defined as the excess of the accrued liability over the assets of the plan at the valuation date. Accrued liability is calculated at the valuation date and is the present value of benefits credited with respect to service earned to that date. "Deficit" is the amount by which a sum of money falls short of the required amount and "debt" is defined as an amount that is owed. It is not uncommon to have parties refer to unfunded liability, deficit, and the debt owed to the system. However, it is not common to hear the term "indebtedness" used when referring to the unfunded liability of the retirement systems.

- a. *How is it calculated?*

Each year an actuarial valuation report is produced for the PERS and TRS retirement systems in order to obtain an up-to-date figure of the total liability for the entire system. An actuarial valuation produces an estimate of total liabilities, at a given point in time; however, it does not change the ultimate cost of the system. Actuarial valuations use assumptions to determine what the total cost

will be over the life of the system. These assumptions reflect the major variables that will affect total system costs, and the cost of any one individual. The actuarial valuation report determines the expected future obligation by measuring the plan liabilities and plan assets. The retirement plans funding ratio is determined by comparing the liabilities of the plan with the assets of the plan. A primary objective of the actuarial valuation report is to determine the employer contribution rate in order to fund and pay for future benefits.

- b. *Is it likely that the events on which the calculation is based will occur?*

Every state in the country with an underfunded pension system has realized that assumptions used in the actuarial valuations and actual experience differ. Our goal is to select a qualified and professional actuary that will make estimates based on the best information available at the time.

3. *What does that liability mean in general and in particular for:*

- a. *State finances*—Enclosed is information showing the projected costs through FY09 and the valuations show total employer contributions amounts through 2030.
- b. *Credit rating*—This question would be more appropriately answered by the Department of Revenue.
- c. *Additional appropriation*—In accordance with SB 141 the Alaska Retirement Management Board may end up recommending as part of its analysis of the retirement systems that additional appropriations are warranted to shore up the retirement systems.
- d. *Retirees*—There will be no impact on retirees.
- e. *Current employees here, especially with regard to take-home pay vs. total compensation, will pensions and health care costs for current employees or retirees be negatively affected by the liability.*—There is no direct impact on current employees; however, rising employer contribution rates will have an impact on future budgets. Response to impact for retirees is noted above.
- f. *Payment of benefits (medical and pension)*—Retirees will continue to receive benefit payments for medical and pension.

4. *When did the unfunded liability begin and over what period of time has there been a liability?*

While the magnitude of the underfunded status was not known until April 2003 and after the start of this administration, many events over the last 10 years led to our current condition. It is difficult to pinpoint at what exact point the unfunded liability began, but our experience and audit of our actuaries have determined that (1) employer rates were reduced in the 1990s when investment returns were high, (2) medical assumptions starting in the late 1990s were too low, (3) investment returns in 2000, 2001, and 2002 did not meet the annual investment targets, and (4) the asset valuation method was changed as a result of the audit.

5. *When was the current magnitude of the present unfunded liability projected?*

See above—a copy of the 2002 actuarial valuation was finalized in April 2003, in accordance with the normal schedule for valuations.

6. *What is the division's position on the causes of the unfunded liability?*

Three primary factors contributed to the unfunded status: (1) rising health care costs; (2) loss of investment income; and (3) change in assumptions to reflect changing conditions.

Have actuaries done sensitivity analysis on various assumptions like rate of return on assets and rates of increase in medical costs?

The actuarial valuations do provide a sensitivity analysis regarding the effect on the retirement systems given specific key assumptions that involve the investment assumption, for example, the effect of investment returns of 7.5%, 8.25%, or 9% for all future years (see enclosure). Additionally, the enclosed information shows what happens to the employer contribution rate if liabilities increase by 5% and as assets decrease by 5% (see enclosure).

7. *Should the legislature make an appropriation next year to reduce the liability?*

SB 141 prescribes that the Alaska Retirement Management Board will take up this question, "The Alaska Retirement Board shall report to the legislature . . . short-term and long-term recommendations for addressing the unfunded liability of the retirement plans."

8. *When does the legislature have to fund the liability or when will the legislature (and state) face a cash flow problem?*

The 5% annual contribution increase, in and of itself, creates a cash-flow problem for many PERS and TRS employers. As set out in the actuarial valuations for PERS and TRS, the actuary has recommended that the employer contribution rates go up to 28.19% for PERS and 41.78% for TRS as of the June 30, 2004, draft valuations. This increase results in TRS employer contributions increasing from \$151 million in FY06 to \$282 million in FY09, without any changes in services.

It is expected that the employer contribution rates will continue to rise until they reach the calculated rate and remain at these levels for approximately twenty-five years, which is the amortized period to pay off the unfunded liability. Note: For every year that the employers are not contributing at the actuarially calculated rate it has the effect of increasing the unfunded liabilities of the retirement systems.

9. *Should the legislature worry about the liability or will it fix itself?*

According to Mark Johnson, Actuary with Milliam USA, in response to the question, "Can the CALTRS pension system invest its way out of its unfunded status?" Mr. Johnson concluded that the answer was "no." He said there was one chance in ten that CALTRS would be able to invest its way out of its underfunded status given the projections concerning future market conditions.

SB 141
supersedes

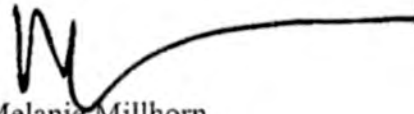
Basically there are three levers that could act to improve the systems underfunded status: (1) systems could experience higher investment returns than projected; (2) reduce benefits costs; or (3) receive a cash infusion in order to reduce or eliminate the unfunded liability. SB 141 acts to address the future growth in the unfunded liability and also by establishing the Alaska Retirement Management Board it acts to address the unfunded liability for the systems.

10. *What approaches do you recommend to address the liability?*

As noted above, the division will await the report of the Alaska Retirement Management Board and its recommendations due to the legislature this session.

Please let me know if you have any questions about this correspondence.

Sincerely,

A handwritten signature in black ink, appearing to be 'W' followed by a long horizontal stroke.

Melanie Millhorn
Director

MM/ck

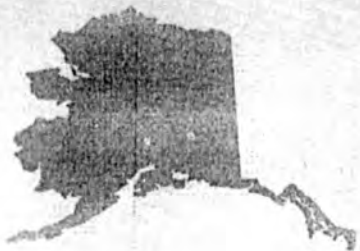
Enclosures

cc: Members of Special Committee on Ways and Means

Ray Matiashowski, Commissioner
Department of Administration

Kevin Brooks, Deputy Commissioner
Department of Administration

Michael Tibbles, Deputy Commissioner
Department of Administration



Questions posed from June 15, 2005, letter received from Representative Weyhrauch. With respect to PERS and TRS, what part of the unfunded liability is represented by health or retirement benefits?

PUBLIC EMPLOYEES' / TEACHERS' RETIREMENT SYSTEM INFORMATION BRIEFING

SUBJECT: PERS / TRS Tier Classification Medical Benefits

DATE: JANUARY 10, 2005

NOTE: AS OF DECEMBER 2004 THERE ARE 27,095 PERS/TRS MEMBERS RECEIVING A RETIREMENT AND MEDICAL BENEFIT. IN ADDITION, THERE ARE 24,947 COVERED DEPENDENTS FOR A TOTAL OF 52,042 MEMBERS AND DEPENDENTS WITH MEDICAL COVERAGE.

PERS	Tier 1	Tier 2	Tier 3	Total
Active	7,916	9,086	16,878	33,880
Deferred Vested	2,864	2,785	393	6,042
Deferred	1,871	3,079	7,188	12,138
Retired	17,352	2,041	101	19,494
Total	30,003	16,991	24,560	71,554
Medical Benefits	System paid medical benefits for all benefit recipients and their eligible dependents. Eligible after vesting and normal retirement age of 55 or early retirement at age 50.	System paid medical benefits for Police / Firefighters after 25 years or "all others" at 30 years of service. Eligible after vesting and age 60. Under 60 must pay premium. Disabilitants, regardless of age receive medical coverage.	System paid medical benefits for Police and Firefighters after 25 years or "all others" at 30 years of service. Eligible at age 60 after vesting; 10 years of credited service to qualify. Under age 60 must pay premium. Disabilitants, regardless of age receive medical coverage.	

TRS	Tier 1	Tier 2	Total
Active	3,204	7,037	10,241
Deferred Vested	404	259	663
Deferred	601	1,947	2,548
Retired	8,462	184	8,646
Total	12,671	9,427	22,098
Medical Benefits	System paid Medical benefits for all benefit recipients and their eligible dependents. Eligible after vesting and normal retirement age of 55 or early retirement at age 50.	System paid medical benefits for teachers after 25 years of service. Eligible after vesting and age 60. Under 60 must pay premium. Disabilitants, regardless of age receive medical coverage.	

(Above member counts for both systems are as of October 11, 2004)

Note: Medical benefits account for a significant portion of the Systems liabilities.

PERS: 37% of accrued liability and 31% of accrued liability for TRS.



Liabilities Due to Pension and Medical (000's)

Accrued Liability

	<u>PERS</u>		<u>TRS</u>	
Non-medial	\$7,189,244	63%	\$4,216,480	69%
Medical	<u>4,254,672</u>	37%	<u>1,907,120</u>	31%
Total	\$11,443,916		\$6,123,600	

Alaska Public Employees' Retirement System - Teachers' Retirement System
Composite Employer Contribution - Increase Amount and Total Contributions
FY 06 - 07 - 08 - 09
(in Millions of Dollars)

Fiscal Year	State of Alaska		University of Alaska		School Districts		Municipalities		Total All Categories	
	Increase	Total	Increase	Total	Increase	Total	Increase	Total	Increase	Total
FY 06	40.0	142.1	7.8	26.3	38.6	151.5	21.7	66.6	108.1	386.5
FY 07	41.5	188.9	8.0	35.2	39.7	195.2	22.5	91.6	111.7	510.9
FY 08	43.0	238.9	8.3	44.8	41.0	242.6	23.3	118.4	115.6	644.7
FY 09	8.9	257.1	3.4	49.8	31.4	282.1	4.7	127.6	48.4	716.6

Notes: Conformed to the 2004 Actuarial Valuation (using June 30, 2003 financial statements), by projection year
5% a year increase in employer composite rate until required computed total rate is reached.
Each subsequent year affected by change in rate, increase in salaries -

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Division of Retirement & Benefits



State of Alaska

Projections Under Different Economic Scenarios – Key Assumptions

All assumptions and methods are the same except:

- Results are shown only under the 1% population growth scenario
- The actuarially calculated contribution rate is adopted in each year, but rate increases are assumed to not exceed 5%
- Investment returns are assumed as follows:

Total Portfolio Investment Return Under Each Scenario:

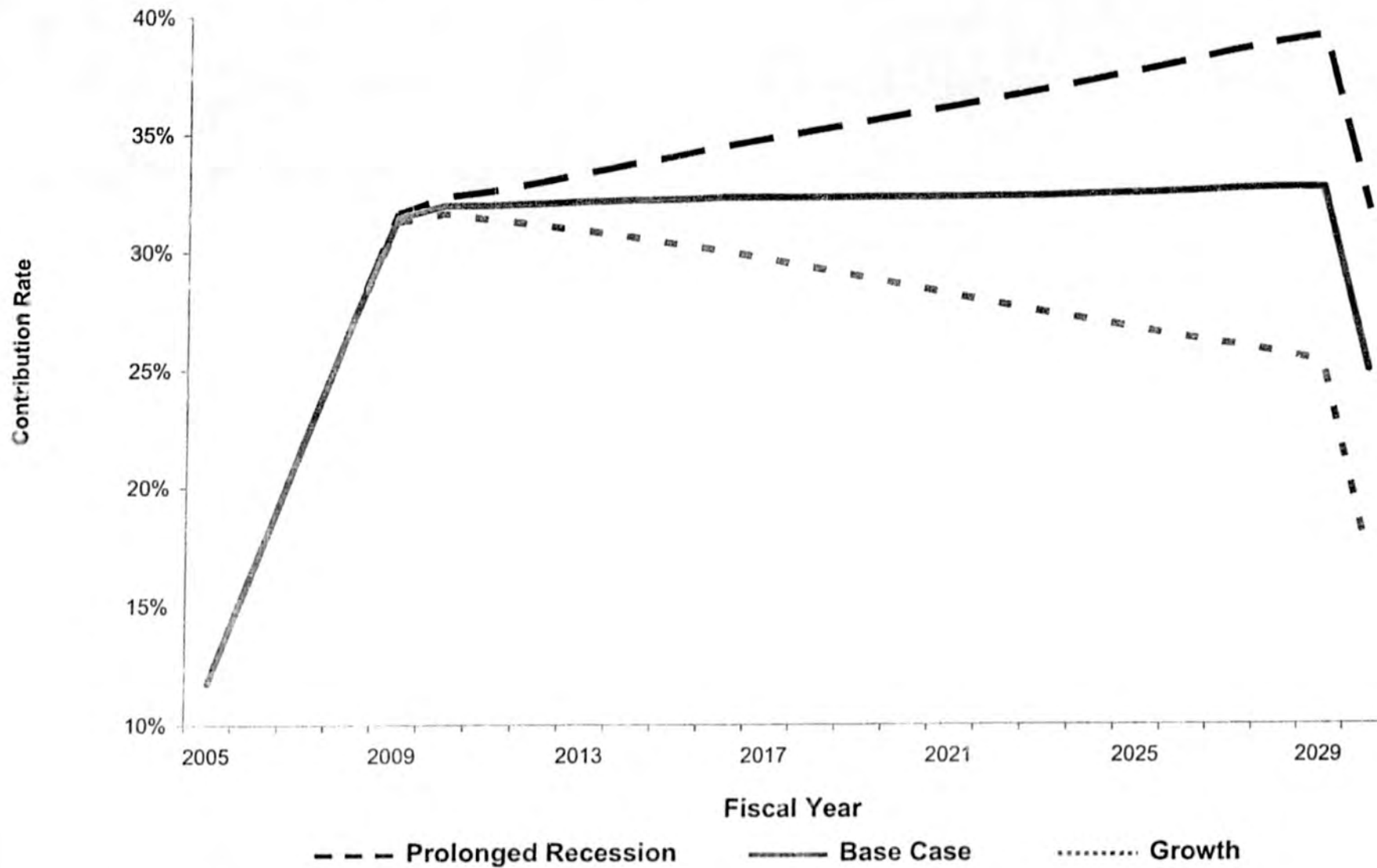
Base Case: 8.25% for all future years

Optimistic: 9.00% for all future years

Pessimistic: 7.50% for all future years

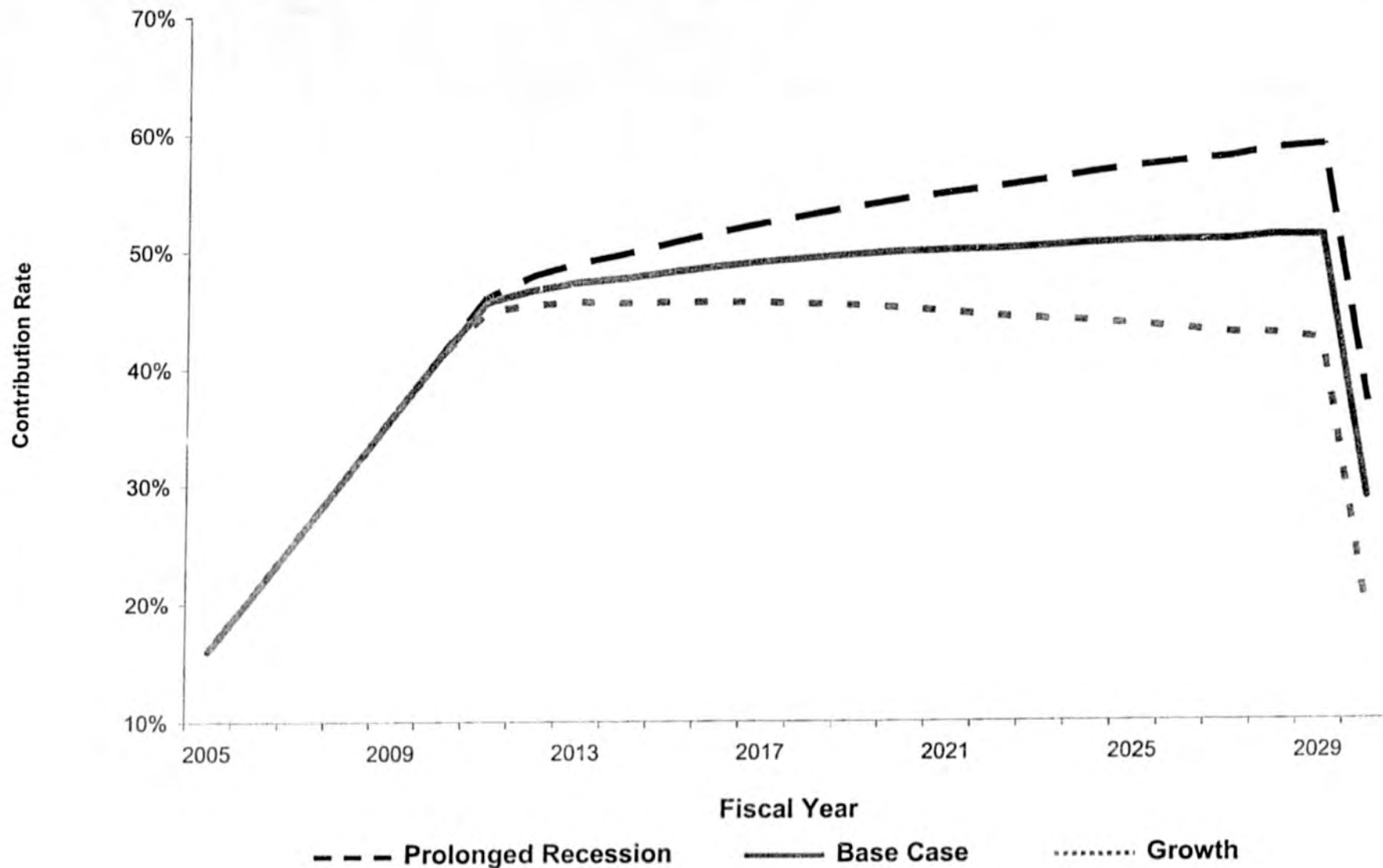
State of Alaska - PERS

Economic Scenarios – Projected Contribution Rates
Annual Population Increase 1%



State of Alaska - TRS

Economic Scenarios – Projected Contribution Rates
Annual Population Increase 1%



Hypothetical Effect of Changes in Liabilities and Assets

Hypothetical Increase in Calculated Rate

	<u>PERS</u>	<u>TRS</u>
5% liability increase	3.40%	4.70%
5% market asset decrease	0.30%	0.50%

Liability changes may affect both normal cost and accrued liabilities

Asset changes are “smoothed” twice

- gains and losses are recognized over 5 years
- change in unfunded is then amortized over 25 years

Asset changes increase rates for 4 more years

- cumulative effect is 5 times first year effect

STATE OF ALASKA

DEPARTMENT OF ADMINISTRATION

DIVISION OF RETIREMENT AND BENEFITS

FRANK H. MURKOWSKI, GOVERNOR

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AUG 26 2005

August 24, 2005

The Honorable Bruce Weyhrauch, Chair
Special Committee on Ways and Means
House of Representatives
State Capitol, Room 421
Juneau, Alaska 99801-1182

Re: Follow-up From Special Ways and Means Meeting on July 14, 2005

Dear Representative Weyhrauch:

This letter is written in response to questions raised and requests made by members of the Special Committee of Ways and Means during the meeting on July 14, 2005. As a consequence of the time constraints during the meeting, I was not able to expand on several of the topics raised and wanted to take this opportunity to provide the members with some supplemental information as outlined below.

2002 Actuarial Audit of PERS / TRS - Milliman USA

Enclosed is a copy of the actuarial audit report prepared by Mark Johnson, F.S.A., Consulting Actuary with Milliman USA dated October 24, 2002, as requested by Representative Rokeberg. It is important to note that in addition to the actuarial valuation reports that are provided to the legislature annually in accordance with existing statute provisions that SB 141 prescribes additional reporting functions by the Alaska Retirement Management Board to the legislature.

For example, Section 141 of the bill states that the Alaska Retirement Management Board shall provide a report to the legislature by the 15th day after the first regular legislative session that includes: (1) preliminary assessment of the financial health of all public employees' retirement plans and all teachers' retirement plans; (2) assessment of the actuarial services purchased by the board; (3) recommendations for additional legislative or administrative policy to improve the financial health of the retirement plans; (4) short-term and long-term recommendations for addressing the unfunded

liability of the retirement plans; and (5) recommendations for legislative procedures regarding fiscal notes for new legislation affecting retirement plans.

Regulation 2 AAC 35.900 – Maximum Employer Contribution Rate Change

This regulation for PERS states that the maximum change in the contribution rate for an employer from one year to the next shall be no more than five percentage points, as actuarially calculated, whether the change is an increase or a decrease. The regulation was established at the request of Municipality of Anchorage (MOA) for budgetary purposes on May 17, 1991. Representative Wilson had raised concerns about this regulation during the meeting. This regulation is scheduled to be repealed as part of SB 141.

AS 39.35.475 and AS 14.25.143 - Ad Hoc PRPA and Automatic (PRPA)

There are two versions of Post Retirement Pension Adjustment found in the above statutes. The ad hoc PRPA is based on the change in the cost of living in the Consumer Price Index (CPI) for Anchorage. Only Tier 1 members of PERS and TRS are eligible for the ad hoc PRPA, which is based on the financial condition of the retirement systems and is therefore discretionary. The amount of the ad hoc PRPA will not exceed four percent compounded for each full year in which benefits have been received. Because the ad hoc is discretionary the system does not pre-fund for this benefit.

As I mentioned during the meeting, the Commissioner of Administration has not approved an ad hoc PRPA for the last three consecutive years (2003, 2004, and 2005). Additionally, SB 141 recognized the significant cost associated with this benefit, which represents \$400 million of the unfunded liability over the last ten years. As a result, SB 141 requires that the systems' funding ratio be at 105 percent before an ad hoc PRPA can be granted in the future.

Additionally, as part of Tier II legislation for PERS and TRS members the legislature enacted an automatic PRPA. This benefit is available to retirees who are age 60 and over and those who have received benefits for 5 years. The automatic PRPA is 50 percent or 75 percent (for members who are age 65) of the cost of living increase from the prior year as identified in the Anchorage Consumer Price Index (CPI). This benefit is pre-funded through employer contribution rates.

Actuarial Services RFP

The Division has released an RFP for actuarial services. The schedule to award a contract for actuarial services to the successful bidder is October 1, 2005. It

is anticipated that the Division will receive bids from multiple nationally recognized actuarial firms that specialize in government sector pension plans.

Actuarial Valuation 2005

It was mentioned during the hearing that a valuation for PERS and TRS should be conducted as soon as possible. Actuarial valuations are conducted on the PERS and TRS on an annual basis. The schedule has been for the Division to send the data to the actuary after the payroll records can be verified and confirmed for the period ending June 30, 2005. This information is normally sent to the actuary in September in order to produce a valuation for Board review and adoption. The valuation process from beginning to end takes approximately six to seven months. After the Board adopts the valuations, it becomes final and is provided to the Governor and to the legislature.

The cost for a valuation for PERS and TRS is approximately \$70,000. Based on RFP for actuarial services being sought, it appears this schedule can still be maintained.

Rising Medical Costs

A request was made by Representative Gruenberg about information related to rising medical costs. Specifically, he was interested to know why medical costs are rising. This request is being researched and will be provided once the research is completed.

Union Participation in New Tiers

A concern was raised during the meeting that the various Unions may not have had an opportunity to be actively involved in discussion about new Tiers. I wanted to provide background information to address this concern. In January of 2004, the Commissioner of Administration launched an initiative to have Board members from the Public Employees' Retirement System and the Teachers' Retirement System research and study the design of new Tiers.

As part of this process, several public meetings were held regarding new Tiers including a survey sent to 12 collective bargaining units in June of 2004. Additionally, two unions participated in several of the Tier Sub-committee meetings, which were NEA and RPEA, which represents Retired Public Employees' Association.

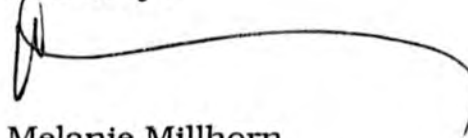
In closing, the Division is committed to assisting the Ways and Means Committee in their efforts to review the PERS and TRS matter. As mentioned

Chair Weyhrauch
Special Subcommittee on Ways and Means
Page 4
August 24, 2005

in earlier correspondence, it would be beneficial for the Division to receive information about the resource needs for the committee so that any additional costs are identified appropriately for budgetary purposes. Further, it would be beneficial to know if the Special Committee on Ways and Means will have inquiries of the Division's actuarial consultant or need additional work to be performed by the actuary.

Please let me know if you have any questions about this correspondence.

Sincerely,

A handwritten signature in black ink, appearing to be 'Melanie Millhorn', with a long, sweeping horizontal line extending to the right.

Melanie Millhorn
Director

Enclosure (Executive Summary of Milliman USA audit)
cc: Members of Special Committee on Ways and Means

Ray Matiashowski, Commissioner
Department of Administration

Kevin Brooks, Deputy Commissioner
Department of Administration

State of Alaska

**Actuarial Audit of
TRS & PERS**

October 24, 2002

**Mark O. Johnson, F.S.A.
Consulting Actuary**