

ATLANTA COUNTY COURTS
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HB 210

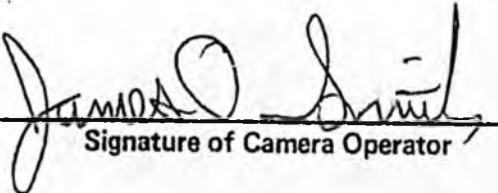
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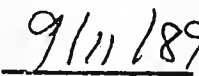


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Signature of Camera Operator


Date

HB

210

STATE OF ALASKA
THE LEGISLATURE

FEB 27 1985

POUCH Y - STATE CAPITOL
JUNEAU, ALASKA 99811
907 465 3800

LEGISLATIVE AFFAIRS AGENCY

MEMORANDUM

February 27, 1985

SUBJECT: Longevity bonus bills -- sectional analysis
(HB 210 and HB 222))

TO: Representative Katie Hurley
Chair, House State Affairs Committee

FROM: Keith B. Levy *KBL*
Legislative Counsel

You have requested a sectional analysis of HB 210 and HB 222, both of which amend the longevity bonus program and establish an annuity program using permanent fund dividends. HB 222 is based on HB 210, which is identical to CSSB 56 (State Affairs). However, there are a number of substantive differences between the two House bills. Therefore, the following is a sectional analysis of HB 210, with a summary of the differences between HB 210 and HB 222 at the end. For your convenience, the discussion of each section of HB 210 contains a reference to the comparable provision of HB 222 and indicates which sections are identical.

ANALYSIS OF HB 210

Section 1. This section sets out legislative findings and states the purposes of the longevity bonus program and the annuity program. (See sec. 1 of HB 222.)

Sections 2, 4, 5, 6, 7, 9, and 14. These are "cleanup" sections that amend existing provisions in the permanent fund dividend chapter (AS 43.23) to refer to either cash payments or annuity credits or both, as appropriate. These changes are necessary because the bill creates the option of taking the permanent fund dividend in the form of cash or an annuity credit (see sections 3 and 16). (Sections 6 and 7 of HB 210 are not contained in HB 222. Sections 2, 4, and 5

of HB 210 are identical to secs. 2, 4, and 5 of HB 222. Sections 9 and 14 of HB 210 are identical to secs. 6 and 10, respectively, of HB 222.)

Section 3. This section provides that a person who is eligible to receive a permanent fund dividend or to claim the dividend on behalf of another will receive an annuity credit unless that person elects to take the dividend in cash. It also provides the option to take a minimum of 25 percent of the dividend in cash and the balance as an annuity credit. However, a person who is 65 years of age before January 1, 1986, has no choice and must take the dividend as cash (AS 43.23.005(d)). (See sec. 3 of HB 222.)

Section 8. This section provides that the permanent fund dividend application must be prepared to allow an individual to elect to receive cash in lieu of an annuity credit (AS 43.23.015(i)). (Section 8 of HB 210 is not contained in HB 222.)

Section 10. This section allows the commissioner of revenue to direct the commissioner of administration to debit a person's annuity account, after notice and an opportunity for hearing, if the account was wrongly credited. The debit must be made within ten years if the credit is the fault of the individual and within three years if it is the fault of the state (AS 43.23.035(c)). (Section 10 of HB 210 is identical to sec. 7 of HB 222.)

Section 11. This section amends the duties of the Department of Revenue with respect to permanent fund dividends to make it clear that cash dividends are to be paid only to individuals who elect cash or are 65 years of age before January 1, 1986. It also requires the Department of Revenue to provide the commissioner of administration with information necessary to administer the annuity program (AS 43.23.055). (See sec. 8 of HB 222.)

Section 12. AS 43.23.065 currently makes 50 percent of the cash permanent fund dividend exempt from attachment to satisfy a debt and provides certain exceptions to the exemption. This section of the bill amends AS 43.23.065 to provide another exception to the exemption. No part of the cash dividend is exempt from attachment to satisfy court ordered restitution under AS 12.55.045 - 12.55.051 or

AS 12.55.100. (Section 12 of HB 210 is identical to sec. 9 of HB 222.)

Section 13. This section amends AS 43.23.065 to allow the Department of Revenue to force an individual who has a past due child support obligation to take the permanent fund dividend in cash. It also allows state courts to exercise the same power as a condition of any civil judgement or order of restitution. (Section 13 of HB 210 is not contained in HB 222.)

Section 15. This section redefines the term "permanent fund dividend" to mean a credit to an annuity account, except with respect to individuals who receive cash, in which case it means the cash payment (AS 43.23.095(6)). (See sec. 11 of HB 222.)

Section 16. This section sets up the annuity program by adding a new article to AS 43.23. An annuity investment fund is established consisting of an amount equal to the permanent fund dividends taken as annuity credits. The money is transferred from the dividend fund to the annuity investment fund annually (AS 43.23.110(a)). The legislature is also authorized to appropriate money to the annuity investment fund from the general fund or the undistributed income account. These extra funds are to be allocated to individual annuity accounts according to a "front-loading" formula that increases the annuity account balance according to age. Under the formula, there is a base credit, depending on the size of the appropriation, that applies to individuals 18 through 35 years old. For each year of age over 35 up to 65 years of age, there is an incremental credit increase, based on "historical and projected permanent fund returns on investment" (AS 43.23.110(b)).

The annuity investment fund is to be invested in the same kinds of investments authorized for the Public Employees Retirement System (AS 39.35.110), except that it may be invested in commercial insurance contracts (AS 43.23.110(f)), and individual annuity accounts are to be credited with the same interest rate that the annuity investment fund earns (AS 43.23.110(c)). The legislature may appropriate money from the annuity investment fund to the Department of Administration to pay annuities (AS 43.23.110(d)) and may also pay administrative costs of the annuity program out of the annuity investment fund, allocating the costs equitably among the individual annuity accounts (AS 43.23.110(f)).

The annuity program is to be administered by the commissioner of administration who must maintain records of individual annuity accounts, make annuity payments, and may adopt regulations to implement the program (AS 43.23.120).

An individual becomes eligible for an annuity payment at age 65 if the individual has received one or more annuity credits (AS 43.23.130(a)). The payment is based on the principal and interest accrued to the individual's annuity account, may not vary on account of the individual's sex, and is paid for the life of the annuitant (AS 43.23.130(b)). An individual does not have to be a resident of the state at the time of payment to be eligible for an annuity payment (AS 43.23.130(c)).

An annuity account may not be transferred to another individual or to the individual's estate and the right to receive an annuity terminates when the individual dies, unless the individual dies before age 65 (AS 43.23.110(d)). If a person dies before age 65, a lump sum payment, subject to appropriation, is to be made to the surviving spouse or other designated beneficiary. The lump sum payment includes permanent fund dividend contributions by the individual and interest on those contributions, but does not include funds credited to the account from legislative appropriations and interest on those funds (AS 43.23.130(e)).

An individual does not receive a vested property right in an annuity payment until that payment is made; the state is not obligated to provide annuity payments for annuity credits granted (AS 43.23.130(f)). This means that the annuity program is not an entitlement. An individual would have no legal recourse if the state decided not to make annuity payments even after the individual credited his or her annuity account for many years. (See sec. 12 of HB 222.)

Section 17. This section amends existing law to remove the language that makes the longevity bonus payment \$250 a month. (Section 17 of HB 210 is identical to sec. 13 of HB 222.)

Section 18. This section provides that, except for people who are 65 years of age before January 1, 1986, the monthly longevity bonus payment equals \$250 a month, increased by three percent a year beginning in fiscal year 1987, minus the maximum possible annuity payment a person would receive if they elected an annuity credit each year from the

beginning of the annuity program (AS 47.45.015(a)). For those people who are 65 years of age before January 1, 1986, the longevity bonus is \$250 a month, increased by three percent a year, but without the reduction for the maximum possible annuity payments (AS 47.45.015(b)). This means that, except for those who turn 65 before January 1, 1986, as the maximum possible monthly annuity payment increases, the longevity bonus payments will decrease, regardless of whether the particular individual elected to receive annuity credits. This will have the effect of phasing out the longevity bonus over time, since the annuity payment will eventually exceed the longevity bonus payment. Those who turn 65 before January 1, 1986, will continue to receive the full longevity bonus, increased by three percent annually, since they will be ineligible to receive annuity credits (see sec. 3 of the bill). (See sec. 15 of HB 222.)

Section 19. This section amends existing law to provide that a person residing in a nursing home is ineligible to receive a longevity bonus, unless the person provided the principal support of a spouse when the person entered the nursing home (AS 47.45.070). In that case, the person may continue to receive the longevity bonus until the spouse qualifies to receive a bonus. (Section 19 of HB 210 is identical to sec. 16 of HB 222.)

Section 20. This section amends the provision of chapter 38, SLA 1984, that would have repealed the existing longevity bonus program on June 30, 1985, to provide that the program is not repealed. (Section 20 of HB 210 is identical to sec. 18 of HB 222.)

Section 21. This section repeals the provision of existing law (AS 43.23.045(c)) that allowed the Department of Revenue to adopt a plan to permit an individual to elect a payment plan under the permanent fund dividend program that would minimize the federal tax consequences of the program. (Section 21 of HB 210 is identical to sec. 19 of HB 222.)

Section 22. This section provides that, even if the bill is enacted in 1985, it applies only to permanent fund dividends beginning in 1986 and the dividend for 1985 would be paid under the law as it existed before the bill was enacted. (Section 22 of HB 210 is identical to sec. 20 of HB 222.)

Section 23. This section provides for an immediate effective date. (Section 23 of HB 210 is identical to sec. 21 of HB 222.)

SUBSTANTIVE DIFFERENCES BETWEEN HB 210 and HB 222

Section 1 of HB 222, the purpose and findings clause, has been changed from sec. 1 of HB 210 to reflect the substantive differences in the bill. It also contains a paragraph not found in HB 210 that indicates legislative intent to maintain the annuity program even if the PFD program is eventually repealed.

Section 3 of HB 222 provides that the PFD must be taken half in the form of cash and half as an annuity credit. This differs from sec. 3 of HB 210 which allows an individual to elect to take between 25 and 100 percent of the PFD in cash. This difference is also reflected in other sections of HB 222 that make technical amendments to existing provisions of law. Sections 6, 7, 8, and 13 of HB 210, which reflect the ability to make the election between cash and an annuity credit, are not contained in HB 222. Both bills provide that a person who is 65 or older before a certain date must take all of the dividend in cash, but HB 222 makes that date July 1, 1986 whereas HB 210 makes the date January 1, 1986. This difference is reflected throughout the bill.

Section 3 of HB 222 also provides that a person with a gross income over \$25,000 in a single year who is eligible for the PFD and longevity bonus programs must choose between the two and may not receive both for that year. Section 14 of HB 222 contains the same clause. This provision is not contained in HB 210.

AS 43.23.130(e), added by sec. 12 of HB 222, provides that if a person leaves the state permanently before the age of 65, that person may elect to take the money contributed to the annuity account plus interest in the form of a lump sum payment. Section 16 of HB 210 only allows lump sum payment if the annuitant dies before reaching age 65.

Section 18 of HB 210 provides for the \$250 monthly longevity bonus payment to be increased by three percent a year beginning in fiscal year 1987. HB 222 does not include this provision.

Representative Katie Hurley
February 27, 1985
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Finally, section 17 of HB 222 provides that the longevity bonus program is to be funded only through automatic annual transfers from the undistributed income account in the Alaska permanent fund, and no other source. In contrast, HB 210 leaves the longevity bonus funded in the current manner, through general fund appropriations.

If I may be of further assistance, please feel free to contact me.

KBL:ojb
J12/024

STATE OF ALASKA

Bill Sheffield, Governor

DEPARTMENT OF ADMINISTRATION

DIVISION OF PIONEERS' BENEFITS
PIONEERS' HOME-LONGEVITY BONUS

POUCH CL (MS 0211)
JUNEAU, ALASKA 99811
PHONE: (907) 465-4416

STATE SPECIAL COMMITTEE ON THE
ALASKA LONGEVITY BONUS PROGRAM

February 13, 1985

Alaska State House of Representatives
Pouch V
Juneau, Alaska 99811

Dear Representatives:

COMMENTS ON SENATE STATE AFFAIRS COMMITTEE CONSIDERATION OF ANNUITY BILL

The State Special Committee on the Alaska Longevity Bonus Program is aware that several changes were considered or made in the bill recommended by our committee when that bill (SB 56) was in the Senate State Affairs Committee. We therefore pass on to you our comments on these aspects of the bill.

1. The three percent escalator.

A motion was made and defeated in the Senate State Affairs Committee to delete the provision of the bill which provides that the Longevity Bonus be increased by 3% annually. Our committee recognizes that the 3% escalator is one of the most expensive features of the bill. The comparative costs estimated through the year 2034 are: 1/

1/ Cost estimates prepared by the Division of Strategic Planning, OMB, 2/7/85.

Nevalle

Committee bill (without front loading) 2/

	With 3% escalator	Without escalator
Nominal dollars	\$1,402	\$916
Constant 1985 dollars	784	566
Present value in 1985	617	464

Our committee included the escalator in recognition of the fact that the original longevity bonus was increased rapidly over time from \$100 to \$250. The escalator is not, however, an integral part of the overall structure of the bill. While we felt that pressure to increase the amount of the bonus is inevitable, we hoped that a modest statutory increase would deflect this pressure on the legislature, and that in the long run the provision would prove to be fiscally conservative. While the committee would prefer that the provision remain in the bill, we recognize the fiscal realities which the legislature now faces.

2. Death benefits for those who die prior to age 65.

Our committee did not include death benefits and made receipt of annuity payments dependant upon survival in part for simplicity and in part because the longevity bonus is available only to those who survive. Without death benefits, those who survive would receive a higher annuity because the contributions of those who die would be spread among survivors. We understand that during teleconference hearings there was considerable public testimony that younger individuals would be reluctant to participate in the program if they thought their contributions would be lost upon death. Certainly, participation is a very important consideration.

Our committee's projections as to the phase out of the longevity bonus payments were made by including the "actuarial gain" to annuity accounts from those who died prior to reaching age 65. Without this gain, annuity payments will be smaller and therefore the longevity bonus must be larger to reach the target amount. As a result, it takes longer for the longevity bonus to phase out altogether. The following chart compares annuity payments including the actuarial gain with payments excluding

2/ For an example of the effect of the 3% escalator on the cost of the bill with three years of front loading, see Exhibit A, attached.

that gain. The example includes three years' front loading, since the effect is more apparent when annuities are larger.

(Example includes three years front loading)

	Without Death Benefits		With Death Benefits	
	<u>Annuity</u>	<u>ALB</u>	<u>Annuity</u>	<u>ALB</u>
1987	\$11.92	\$245.58	\$11.92	\$245.58
1990	\$46.94	\$234.44	\$45.55	\$235.83
1995	\$111.73	\$214.46	\$103.72	\$222.47
2000	\$243.52	\$134.63	\$219.97	\$158.18
2004	\$429.25	\$0.00	\$380.64	\$44.97
2006	\$560.18	\$0.00	\$451.53	\$0.00

3. Hold harmless for non-nursing home medicaid benefits.

We understand that the Senate State Affairs Committee heard testimony concerning the loss of medicaid benefits which may occur if receipt of the longevity bonus (which must now be counted as income for Alaskans with less than 25 years residency) results in an individual no longer qualifying for adult public assistance. As you know, our committee included a provision making the longevity bonus unavailable to nursing home residents; thus, the Senate State Affairs Committee was concerned only with the loss of medical benefits to non-nursing home individuals. Commissioner Pugh testified that his department could replace lost benefits if money were appropriated and if it were the intent of the legislature that his department take that action. Thus, that committee passed out the bill with the letter of intent.

Our committee of course supports any action which will protect these individuals. We would only point out that the group of individuals whose longevity bonus is not counted will grow smaller and the group who need this added protection will increase each year. Thus the appropriation which would be necessary for this protection will increase over time.

Sincerely,

State Special Committee on the
Alaska Longevity Bonus Program

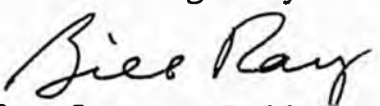

By: Senator Bill Ray
Vice Chairman

EXHIBIT A

Committee bill with three years front loading

	With 3% escalator	Without escalator
Nominal dollars	\$1,387	\$937
Constant 1985 dollars	805	600
Present value in 1985	646	501

STATE OF ALASKA
THE LEGISLATURE

POUCH Y STATE CAPITOL
JUNEAU, ALASKA 99811
907 465 3800

LEGISLATIVE AFFAIRS AGENCY

MEMORANDUM

February 8, 1985

SUBJECT: Longevity bonus/annuity program bill
(CSSB 56 (State Affairs))

TO: Representative Albert P. Adams
Chairman, House Finance Committee

FROM: Keith B. Levy ^{KBL}
Legislative Counsel

You have asked the following questions relating to CSSB 56 (SA), the longevity bonus/annuity program bill:

1. Are the annuity provisions of the bill prohibited by ERISA or other federal or state statutes?
2. What are the implications of AS 43.23.130(f), added by sec. 16 of the bill, which provides that an individual has no vested property right in an annuity payment until that payment is made?

1. Implications of federal/state statutes.

The Employee Retirement Income Security Act of 1974, P.L. 93-406, (ERISA), was enacted by Congress in 1974 to protect certain employees' rights under employee benefit plans maintained for them by their employers or employee organizations if the employer is engaged in interstate commerce or activities affecting interstate commerce. Section 4(a) of the act specifically states the coverages of the act, and refers only to employees and employers. Thus, the act was clearly not intended to apply to the type of annuity plan created by CSSB 56(SA), since there is no employee/employer relationship between the annuitants and the state.

Representative Albert P. Adams
February 8, 1985
Page 2

Moreover, even if the annuity plan could be construed as an employee benefit plan, it would still not be covered by ERISA. Section 4(b) of the act specifically excludes from its coverage governmental employee benefit plans. The term "governmental plan" is defined in sec. 3(32) of the act as

. . . a plan established or maintained for its employees by the Government of the United States, by the government of any State or political subdivision thereof, or by an agency or instrumentality of any of the foregoing. (Emphasis added.)

Accordingly, it is clear that ERISA could not be applied to the annuity plan established in CSSB 56(SA).

I am unaware of any other provisions of federal law that could have an impact on the annuity provisions of CSSB 56(SA) other than the provisions of the Internal Revenue Code. It is my understanding that tax counsel was hired by the Longevity Bonus Committee so that the bill could be prepared to have the least tax impact on annuitants. I would defer to the expertise of tax counsel on matters related to the interpretation of the Internal Revenue Code.

There are a number of provisions of state law related to the establishment of annuity plans in the state (see, e.g., AS 21.45 and 21.48). However, to the extent that these provisions conflict with CSSB 56(SA), the bill would prevail if enacted since it is the later enactment. In any case, nothing in existing law (other than constitutional provisions) could prevent the state from setting up the annuity program the way it wants, since the existing provisions could simply be amended by the legislature. Thus, state law is not an impediment to the provisions of CSSB 56(SA).

2. Vested property rights in the annuity.

AS 43.23.130(f), added by sec. 16 of the bill provides:

An individual does not receive a vested property right in an annuity payment until that payment is made. Notwithstanding this section, the state is not obligated

to provide annuity payments for annuity credits granted under AS 43.23.005.

The significance of this section is that, a person could elect to take the permanent fund dividend in the form of an annuity credit for their entire lives and lose the entire benefit if a future legislature chose to repeal the program or spend the money elsewhere. If the bill is enacted, the state would not be obligated to make annuity payments and a person would have no legal rights to them except for payments already received.

It is clear that an individual has no property interest in a permanent fund dividend payment other than that created by statute. Accordingly, the legislature can set up the statutory scheme so that a person has no vested interest in receiving an annuity payment if that person elects to take an annuity credit instead of a cash permanent fund dividend. In discussing the nature of these kinds of property rights, the United States Supreme Court has said:

To have a property interest in a benefit, a person clearly must have more than an abstract need or desire for it. He must have more than a unilateral expectation of it. He must, instead, have a legitimate claim of entitlement to it.

* * *

Property interests, of course, are not created by the Constitution. Rather, they are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law -- rules or understandings that secure certain benefits and that support claims of entitlement to those benefits. (Emphasis added).

Board of Regents v. Roth, 408 U.S. 564, 33 L.Ed 2d 548, 561, 92 S.Ct. 2701 (1971) (nontenured employee of state university has no property interest in job that would require hearing before dismissal without cause). In other words, an individual has no vested right to benefits from the state unless the statutes creating those benefits create such an entitlement. AS 43.23.130(f) makes it clear that the annuity program is not an entitlement. Thus, if a person were to select an annuity credit under the bill, they would do so knowing that, under the provisions of the bill, they have no

Representative Albert P. Adams
February 8, 1985
Page 4

right to sue the state if they never receive an annuity payment.

If I may be of further assistance please feel free to contact me.

KBL:ojb
J11/067

ANNUITY PROPOSAL

Participation

Participation is the most important consideration surrounding about the annuity proposal. If people choose not to participate in significant numbers, then the plan will not be a success from a social policy perspective.

The following factors may deter participation:

* Income level According to IRS statistics, only 2% of persons with incomes of less than \$10,000 purchase IRA's. People with minimal amounts of disposable income are certainly not going to choose to forego Permanent Fund Dividend cash-in-hand benefits for an investment for which they have to pay cash-out-of-hand payments (taxes).

* Tax status of proposed annuity Without frontloading, the annuity will not be tax-deductible. Investment advisors in the private sector encourage individuals to invest first in an IRA before considering an annuity because an IRA contribution is tax deductible and an annuity contribution is not. (The interest earnings for both are tax deferred).

The amount the legislature frontloads must be a high enough percentage to warrant a favorable tax ruling from the IRS. Finally, there is always the possibility that the legislature will stop frontloading the fund at which time the contribution will be tax-deductible as well as the annual earnings.

* Property right A person who invests in the program will not be able to withdraw his or her contribution. Other annuities allow early withdrawal. (IRA plans allow people to withdraw their money - A penalty tax is imposed for early withdrawal).

* Negative Box check The annuity proposal requires a person to check a box selecting their full dividend payment. If this is not done, a person will automatically receive an annuity credit. Low-income, rural Alaskan Natives will be negatively impacted by this arrangement since it has been documented that they use their dividend check to pay for day to day expenses while higher income Alaskans use the money for taxes and savings. (A study by the Alaska Permanent Fund found that the contribution of dividends to family income was relatively greater in rural Alaska, and especially so for rural Alaska Natives.)

* Lack of assurance that the program will exist in the future Why would an individual investor assume this risk?

Participation in Individual Retirement Accounts--1982

<u>Income Level</u>	<u>Participation Rate*</u>
under \$10,000	2.0%
\$10,000 - \$15,000	6.0
\$15,000 - \$20,000	10.9
\$20,000 - \$30,000	17.6
\$30,000 - \$40,000	28.9
\$40,000 - \$50,000	42.1
\$50,000 - \$100,000	63.7
\$100,000 - \$200,000	78.7
over \$200,000	<u>72.3</u>
all income levels	14.5%

*Participation as a percent of federal tax returns that reported income from wages.

Source: Internal Revenue Service

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The State's deferred compensation plan offers another example of the participation rates one might expect for the annuity program. Under that plan, State employees can place a portion of their earnings in a special account. Tax liability on the deferred amount and on earnings on investments held by the account is deferred until the cash is received. Despite the following factors, only 1,600 to 1,700 (about ten percent) of State employees participate in the deferred compensation plan.

- The deferred compensation plan offers the same tax advantages as the annuity program.
- The amount that is deferred can be controlled by the employee.
- The employee knows how much he will get out of the plan and has several options for obtaining his funds.
- The wealth is not lost if the employee dies; all funds can be passed on to a beneficiary.
- Funds can be removed before the age of 65.
- The solvency of the plan is assured; each account is subject to separate accounting.

MAR 11 REC'D



THE HARTFORD

The Hartford Insurance Group
(203) 547-5000
P. O. Box 568
#1 Waterside Crossing
Windsor, Ct. 06095
March 7, 1985

Mrs. Lois Lind
1705 Willow Drive
Juneau, Alaska 99801

RE: Pending Alaska Legislation

Dear Mrs. Lind:

Donna Brady has asked us to comment on several House bills concerning annuity options attached to the Dividend Program.

It would not appear that much participation could be expected in the Annuity Option. Assuming the annual dividends are taxable income, the dividend would continue to be considered taxable income by the Internal Revenue Service. As long as a resident has the choice between cash or an annuity, the resident would be held to be in constructive receipt of the dividend even if he chose the Annuity Option. Accordingly, current taxes would be due on the dividend regardless of the option chosen.


It's difficult to imagine substantial participation in the program under such circumstances. While it's important to encourage savings for retirement, most such encouragements revolve around tax advantages. The Hartford's experience with savings programs that are not tax sheltered has been dismal.

There would seem to be two possible alternatives to provide a successful annuity option. One would be to make the annuity option mandatory and restrict access to the funds once invested in the annuity contract. This would avoid constructive receipt and current taxation as well as provide for forced savings for retirement. Unfortunately, it also removes a cash distribution as an alternative.

Another option worth considering would be to provide for a larger distribution if the Annuity Option were chosen. This would certainly make this option more attractive and perhaps make up for the negative implications regarding the taxes due on funds invested in the Annuity Option.

I hope you'll find some of my comments useful. Please feel free to call me at (203) 683-8037 if you wish to discuss the situation in further detail.

Very truly yours,



Leslie D. Gubkin, Director
Sales Administration and Support

LDG:tr

cc: Donna Brady, Hartford Variable Annuity, 3828 Carleton St., Anchorage, Alaska
99503

ASSUMED PARTICIPATION RATE BY AGE GROUP

AGE	RATE	AGE	RATE
18	.2%	41	43.5%
19	.4%	42	47.5%
20	.7%	43	51.5%
21	1.0%	44	55.4%
22	1.5%	45	59.3%
23	2.0%	46	63.2%
24	2.7%	47	66.8%
25	3.5%	48	70.4%
26	4.4%	49	73.7%
27	5.5%	50	76.8%
28	6.8%	51	79.7%
29	8.3%	52	82.4%
30	10.0%	53	84.8%
31	12.0%	54	87.0%
32	14.1%	55	88.9%
33	16.6%	56	90.6%
34	19.2%	57	92.1%
35	22.1%	58	93.4%
36	25.2%	59	94.5%
37	28.6%	60	95.5%
38	32.1%	61	96.3%
39	35.8%	62	96.9%
40	39.6%	63	97.4%
		64	97.9%

Prepared by the Division of Strategic Planning.
3/17/85

INDIVIDUAL FRONT-LOADING PAYMENTS BY AGE

ASSUMPTIONS:

(Base amount = \$50.00; Tilt = 10 percent per year)

AGE	AMOUNT	AGE	AMOUNT
1	\$.00	34	\$50.00
2	\$.00	35	\$50.00
3	\$.00	36	\$55.00
4	\$.00	37	\$60.50
5	\$.00	38	\$66.55
6	\$.00	39	\$73.21
7	\$.00	40	\$80.53
8	\$.00	41	\$88.58
9	\$.00	42	\$97.44
10	\$.00	43	\$107.18
11	\$.00	44	\$117.90
12	\$.00	45	\$129.69
13	\$.00	46	\$142.66
14	\$.00	47	\$156.92
15	\$.00	48	\$172.61
16	\$.00	49	\$189.87
17	\$.00	50	\$208.86
18	\$50.00	51	\$229.75
19	\$50.00	52	\$252.72
20	\$50.00	53	\$278.00
21	\$50.00	54	\$305.80
22	\$50.00	55	\$336.37
23	\$50.00	56	\$370.01
24	\$50.00	57	\$407.01
25	\$50.00	58	\$447.72
26	\$50.00	59	\$492.49
27	\$50.00	60	\$541.74
28	\$50.00	61	\$595.91
29	\$50.00	62	\$655.50
30	\$50.00	63	\$721.05
31	\$50.00	64	\$793.15
32	\$50.00	65	\$872.47*
33	\$50.00	66 & OVER	\$.00

* CSSB56 (Jud) provides for payments to persons age 65 (p. 9, line 15). Accompanying calculations assume that payments stop at age 64.

Prepared by the Division of Strategic Planning.
3/17/85

11/29/84

Memorandum to: State Special Committee on the
Alaska Longevity Bonus Program

SUMMARY

Johnson & Higgins was retained to review, as actuaries, technical materials presented to the Committee.

Our review of materials prepared by the Division of Strategic Planning showed their work to be complete and accurate. Our only suggestion is regarding the anticipated level of participation. We feel that lower and higher levels of participation should be examined, since the results will probably vary and are more likely to average well below a 50% participation.

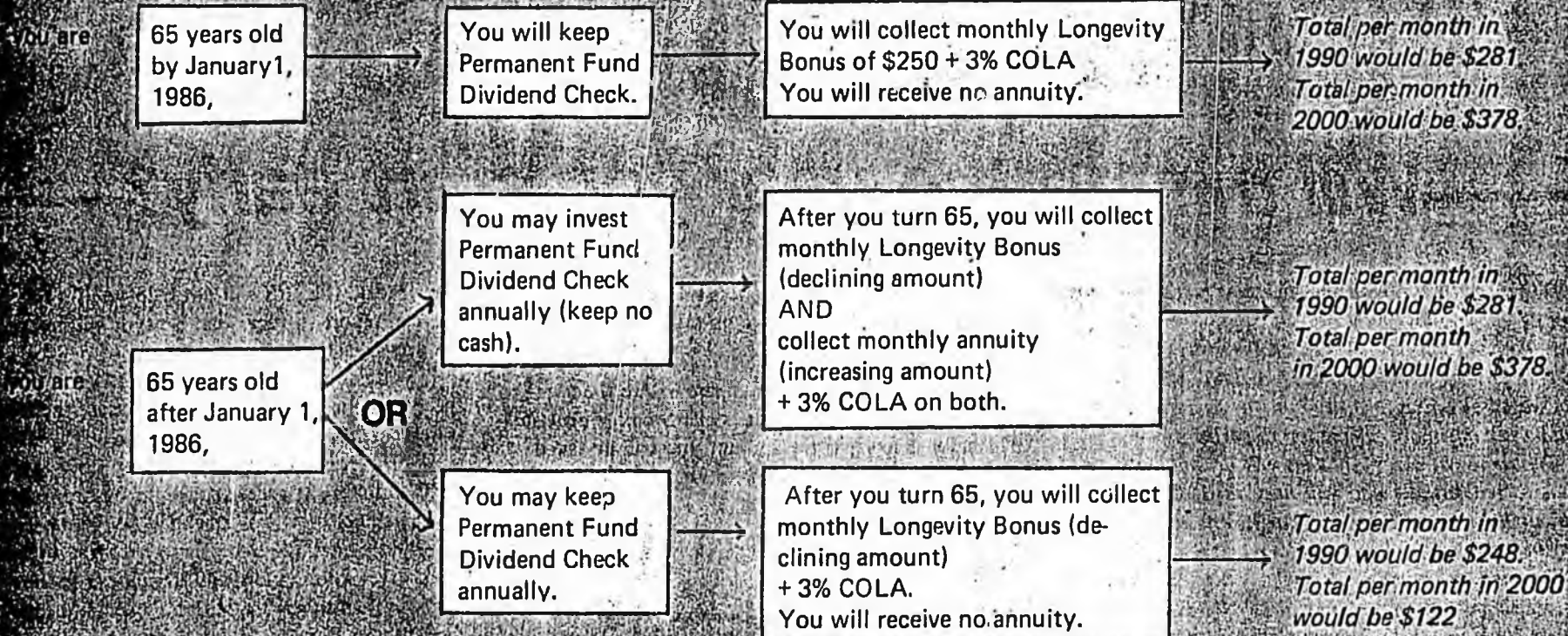
We have expressed some concern over the proposals offered by Benefit Concepts. The investment package they are recommending is very attractive, but we have expressed serious doubt that it can actually be delivered. Further analysis by Benefit Concepts is needed and should be investigated carefully. Our calculations have shown that the proposals offered to date will not be nearly as attractive as suggested by Benefit Concepts.

Senior Vote January 1985

SB56

How annuity would affect you

Senate bill would replace bonus for future seniors



Senior Employment

is available for those 55 and older you may qualify!

Legislature takes up bonus

Continued from page 1

These individuals would receive monthly payments of \$250 plus an annual 3 percent cost of living increase. Payments would be a mix of annuity (likely rising in amount) and Permanent Fund checks today in return for retirement payments in the future. Although the Senate is expected to pass the measure quickly, the plan will likely face rougher going in the House.

less bonus and annuity plans are based on need, state officials say they have been told, about 800 seniors on public assistance will be forced over the income limits for cash and/or medical benefits.

Annuity bill needs complete airing

Our minds are far from settled on SB 56.

That's the bill that would set up an annuity, or retirement plan as a replacement for the current Longevity Bonus Program for Alaska's seniors 65 and over.

A lot of work has gone into this bill. The Longevity Bonus Task Force has met monthly since last August. SB 56 is the result of intensive effort by the nine member task force, its staff and a bevy of experts including government officials, private insurance consultants, lawyers and tax analysts.

Most seniors who participated in teleconference hearings on the bill in late January voiced overwhelming support for the bill, saying they much preferred it to needs-based proposals. Nonetheless, these seniors had concerns about the annuity proposal. We share their concerns.

Under the proposal, many here-and-now seniors - all those 65 and over - would be "grandfathered" into the current bonus program and would continue to receive the current \$250 per month for the rest of their lives.

COMMENTS

For these people, the annuity program would have no effect. They would continue to receive \$250 a month; they would continue to receive a yearly Permanent Fund Dividend check.

But what about the seniors of today who are not yet 65? And the seniors of tomorrow?

Will the program offer a secure investment to younger citizens?

Will estate-conscious Alaskans who want to leave their assets to their children choose this plan, in which benefits end with the death of the recipient? Or, will they choose another more flexible plan for investing their available funds?

Will enough younger citizens of any age join the plan - and give up their Permanent Fund Dividend - to make the annuity fiscally sound?

Will the legislature in future years continue to appropriate money to the plan, as it would have to do annually?

Will the plan provide any benefits to the state's poor who cannot afford to "buy in" at the cost of their annual Permanent Fund Dividend?

Will the plan offer any benefits to 800 current bonus recipients who will lose medical and/or cash public assistance if the program continues to be non-needs based?

You don't set up a retirement program for half a million people - potentially the entire state population - without looking at the plan from every conceivable direction.

In addition to the hard work of the special task force committee, the legislature must be urged to study the plan long and hard.

Hopefully legislators - in both houses - will give not only the annuity proposal, but also these concerns, the full airing they deserve.

LETTERS

Waste led Voice to 'tin cup'?

Dear editor,

I must say I'm quite disappointed with January's issue report. "An urgent appeal to Senior Voice readers," and/or "who pays for Senior Voice?"

For the past two years that I have handled our subscription (my late husband subscribed for the previous two years) I have purchased three subscriptions (two extra) in 1983 and two subscriptions (one extra) last year so I'm certainly among the "Anchorage 99503's paid!"

I do volunteer work at the (Anchorage) Senior Center and I've observed a number of leftover monthly copies on occasion. This is wasteful and uncalled for and could be one of the reasons you again have the "tin cup in hand." I certainly can understand why you must cut back, why haven't you done it before this? Did it take the \$18,000 loss in state and city funding for you to come to this conclusion? It's not hard to figure out why we "pays" couldn't possibly make up for the 1,500 people who receive it "free" or "2,100 to 2,900." This doesn't seem fair to people like me, or to the other paying subscribers especially when a lot more of these freeloaders could have paid, I imagine.

Needless to say, I only wish to renew my single subscription this year with no extra contribution for the "24 or fewer pages per issue" in 1985.

I've decided to add this postscript as a suggestion: If you asked the recipients of gift subscriptions to write a thank-you note to the contributor it would help to convince people like me that my gift copies actually went to someone and were not among the wasted copies I saw at the Senior Center. I know I wouldn't mind sending a card or note if I had been on the receiving end

to show my appreciation.

The cost of a card doesn't amount to \$10 a year! I'm a widow on a fixed income and I gave gladly but I do expect some proof that my money went for what it was intended.

Nancy O. Austin
Anchorage

We agree that there is no excuse for wasting copies of Senior Voice. We appreciate your past and continuing support for Senior Voice and truly regret that

when we have extra copies to give. Usually, these deliveries are made in response to calls from center employees asking for more papers.

At other sites in Anchorage, and at other senior centers around the state, our deliveries are based on past usage. In Anchorage, if our delivery man delivered 20 copies to a site in September, then noticed 15 remained when he delivered the October issue, he would leave fewer October copies. Similarly,

'Needless to say I only want to renew my single subscription. . . with no extra contribution

those extra copies at the Anchorage Senior Center have made you feel Senior Voice is a sloppily-run ship.

Having said as much, let me try to explain some possible reasons for those extra copies, which turned out to be leftover, unwanted and wasted.

First of all, no newspaper worth its typesetter prints exactly as many copies as it will send out to subscribers or place on news stands. When we order a press run of 7,500, there's no practical way to go back and get more. In the past five years, we have run out of papers at least five times because we have underestimated the demand. (We are currently "hoarding" our three remaining copies of last January's issue.)

We almost always print 200 extra papers to prevent running out of Senior Voice when a particular story or report proves popular. Often, these are not "extra" at all and come very close to just meeting the demand.

The situation at the Anchorage Senior Center, we hope,

we have in the past responded to project directors' requests that we send fewer (or more) papers to meet the demand.

With our current funding situation so tight, we are cutting our "extra" copies to 100, which likely will barely cover the demand in the Senior Voice office during the month-between issues.

We can appreciate your skepticism regarding gift subscriptions. Your suggestion that those who "receive" acknowledge their thanks to those who "give" has merit.

However, one of the basic tenets of the Older Americans Act (and the Older Alaskans Commission which partially funds Senior Voice) is that the confidentiality - and consequently the dignity - of those seniors we serve be safeguarded. We currently have on file the cards of more than 80 seniors who have told us they cannot afford to pay, and we suspect that at least double this amount are actually on our mailing list

Senior Voice January 1985

Have YOU

STATE OF ALASKA 1985 LEGISLATIVE SESSION
FISCAL NOTE

Revision Date: _____

Page 1 of 2

REQUEST

Bill/Resolution No.: HB 210

Title: Longevity Bonus/Annuity Program

Sponsor: Taylor

Requestor: _____

Date of Request: _____

FISCAL DETAIL

Agency Affected: Administration

Program Category Affected: Social and Economic Assistance for the Aged

BRU, Program or Subprogram(s) Affected: Longevity Bonus Program

EXPENDITURES/REVENUES: (Thousands of Dollars)

	FY 85	FY 86	FY 87	FY 88	FY 89	FY 90
OPERATING						
100 PERSONAL SERVICES	0	0	0	0	0	0
200 TRAVEL						
300 CONTRACTUAL	0	10.0	0	0	0	0
400 SUPPLIES	0	0	0	0	0	0
500 EQUIPMENT	0	0	0	0	0	0
600 LAND & STRUCTURES						
700 GRANTS, CLAIMS						
800 MISCELLANEOUS						
TOTAL OPERATING	0	10.0	0	0	0	0
CAPITAL	0	0	0	0	0	0
REVENUE	0	0	0	0	0	0

FUNDING: (Thousands of Dollars)

GENERAL FUND	0	10.0	0	0	0	0
FEDERAL FUNDS						
OTHER						
TOTAL	0	10.0	0	0	0	0

POSITIONS:	0	0	0	0	0	0
FULL-TIME	0	0	0	0	0	0
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

ANALYSIS: (Attach a separate page if necessary)

Prepared By: Louis Keller, Director
Division: Pioneers' Benefits

Phone: 465-4400

Date: February 21, 1985

Approved by Commissioner: Lisa Rudd
Agency: Department of Administration

Date: 2-26-85

Distribution (by Agency preparing fiscal note):

- Legislative Finance
- Legislative Sponsor
- Requestor
- Office of Management and Budget
- Impacted Agency(ies)

HB 210
Fiscal Note Analysis
Prepared by Division of Pioneers' Benefits
Department of Administration
February 21, 1985

ASSUMPTIONS

This fiscal note addresses administrative costs only for the Longevity Bonus Program.

Two payment systems will be run in the Division of Pioneers' Benefits. The first would pay a monthly target amount for those eligibles age 65 before January 1, 1986. The second would pay monthly payments, varying each year, for those age 65 after January 1, 1986. The second system would be impacted by information from the Annuity program.

The Longevity Bonus program would need additional resources for modifications to data processing files.

FY 86 Administrative Costs (Start-up)

Contractual Services	\$10,000
Computer System Modification by Contractor	

Printing Costs already in 86 Budget

FY 87 Administrative Costs (Operations)

No Additional Cost

STATE OF ALASKA 1985 LEGISLATIVE SESSION
FISCAL NOTE

Revision Date: _____

Page 1 of 2

REQUEST

Bill/Resolution No.: HB 210
 Title: An act amending the longevit bonus program
 Sponsor: Taylor
 Requestor: _____
 Date of Request: _____

FISCAL DETAIL

Agency Affected: Department of Administration
 Program Category Affected: Centralized Administrative Services
 BRU, Program or Subprogram(s) Affected: BRU, Program or Subprogram(s) Affected:
 Data Processing Services/Annuity Management

EXPENDITURES/REVENUES: (Thousands of Dollars)

Operating	FY 85	FY 86	FY 87	FY 88	FY 89	FY 90
100 Personal Svcs		60.0	63.0	66.2	69.5	72.9
100 Rtmnt & Brfts						
200 Travel						
300 Contractual		20.0	21.0	22.0	23.2	24.3
400 Supplies		.5	.5	.6	.6	.6
500 Equipment		4.0	4.2	4.4	4.6	4.9
600 Land & Struct						
700 Grants, Claims						
700 TRS Match						
TOTAL OPERATING	-0-	84.5	88.7	93.2	97.9	102.7
CAPITAL		750.0				
REVENUE						

FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER		834.5	88.7	93.2	97.9	102.7
TOTAL	-0-	834.5	88.7	93.2	97.9	102.7

POSITIONS:

FULL-TIME		1	1	1	1	1
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

Prepared By: J.K. Humphreys, Director Phone: 465-4470
 Division: Retirement & Benefits Date: 2/21/85

Approved by Commissioner: Lisa Rudd Date: 2-25-85
 Agency: Department of Administration

Distribution (by Agency preparing fiscal note):
 Legislative Finance
 Legislative Sponsor
 Requestor
 Office of Management and Budget
 Impacted Agency(ies)

House Bill 210
Fiscal Note Analysis
Prepared by Division of Retirement & Benefits
Department of Administration

February 21, 1985

IV Analysis: This Fiscal Note addresses costs in the Data Processing Services BRU. We estimate that the annuity program will be fully automated to reduce the need for staff. We estimate that system analysis, development and construction costs would be \$750,000 and would be a capital appropriation from "other funds".

We anticipate the need for one full-time programmer/analyst IV to provide guidance in the development of the annuity systems with the contractors and, after implementation, to provide ongoing maintenance. We also estimate a cost of \$20.0 for computer records storage.

We estimated an inflation rate of 5%. Further, we assumed that "other funds" would be available for FY 86 costs.

STATE OF ALASKA 1985 LEGISLATIVE SESSION
FISCAL NOTE

Revision Date: _____

Page 1 of 2

REQUEST

Bill/Resolution No.: HB 210
 Title: An act amending the
longevity bonus program
 Sponsor: Taylor
 Requestor: _____
 Date of Request: _____

FISCAL DETAIL

Agency Affected: Department of Administration
 Program Category Affected: _____
Labor services
 BRU, Program or Subprogram(s) Affected: _____

EXPENDITURES/REVENUES: (Thousands of Dollars)

Operating	FY 85	FY 86	FY 87	FY 88	FY 89	FY 90
100 Personal Svcs		124.5	164.7	173.0	181.6	190.7
100 Rtmnt & Bnfts						
200 Travel						
300 Contractual		61.0	67.1	73.8	81.2	89.3
400 Supplies		10.6	12.7	15.3	18.3	22.0
500 Equipment		16.0				
600 Land & Struct						
700 Grants, Claims						
700 TRS Match						
TOTAL OPERATING	-0-	212.1	244.5	262.1	281.1	302.0

CAPITAL						
----------------	--	--	--	--	--	--

REVENUE						
----------------	--	--	--	--	--	--

FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER	-0-	212.1	244.5	262.1	281.1	302.0
TOTAL	-0-	212.1	244.5	262.1	281.1	302.0

POSITIONS: -0-

FULL-TIME		4	4	4	4	4
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

Prepared By: J.K. Humphreys, Director Phone: 465-4470
 Division: Retirement & Benefits Date: 2/21/85

Approved by Commissioner: Lisa Rudd Date: 3/1/85
 Agency: Department of Administration

Distribution (by Agency preparing fiscal note):
 Legislative Finance
 Legislative Sponsor
 Requestor
 Office of Management and Budget
 Impacted Agencies

House Bill 210
Fiscal Note Analysis
Prepared by Division of Retirement & Benefits
Department of Administration

February 21, 1985

IV: Analysis: This Fiscal Note addresses costs in the Labor Services Program Category. The cost of the annuity program is anticipated to be borne entirely by the participants. We estimate that approximately four full-time employees will be needed to administer this program on a continuing basis. We estimate that the program supervisor and chief accountant will be needed for the entire first year to assist in the development and analysis of the computer system needs with the other two staff members being needed for only half of FY 86 to assist with the implementation and testing.

We are basing this Fiscal Note on the assumption that the Department of Revenue will verify ages of those who elect to participate in the annuity program. This is critical.

We estimated an inflation rate of 5% in all categories. Further, we assumed that "other funds" would be available for FY 86 costs.

We estimate that four positions are needed to administer this program.

Supervisor: Retirement & Benefits Specialist III
Accountant: Accountant II
Technician: Retirement & Benefits Technician I/II
(6 months FY86, full-time thereafter)
Clerk: Accounting Clerk III
(6 months FY86, full-time thereafter)

We propose that a notification will be sent to all Alaska boxholders to inform them of the provisions of the bill and to advise them of the contact persons or agencies. We estimate an annual cost of \$20.0 for independent audits. We also propose that there will be annual statements of account that will be sent to approximately 150,000 participants. This cost is estimated to be \$41.0 for FY 86.

STATE OF ALASKA 1985 LEGISLATIVE SESSION
FISCAL NOTE

Revision Date

REQUEST

Bill/Resolution No: HB 210
 Title: An act amending the Longevity Bonus and PFD programs
 Sponsor: Taylor and Jenkins
 Requestor: House State Affairs
 Date of Request: 2/25/85

FISCAL DETAIL

Agency Affected: Revenue
 Program Category Affected: General Govt. BRU, Program of Subprogram(s) Affected: PFD BRU - Administrative Services, Enforcement, Public Services

EXPENDITURES/REVENUES: (Thousands of Dollars)

	FY 85	FY 86	FY 87	FY 88	FY 89	FY 90
<u>OPERATING</u>						
100 PERSONAL SERVICES	-	229.2	-	-	-	-
200 TRAVEL	-	2.5	-	-	-	-
300 CONTRACTUAL	-	73.5	-	-	-	-
400 SUPPLIES	-	1.0	-	-	-	-
500 EQUIPMENT	-	-	-	-	-	-
600 LANDS & STRUCTURES	-	-	-	-	-	-
700 GRANTS, CLAIMS	-	-	-	-	-	-
800 MISCELLANEOUS	-	-	-	-	-	-
<u>TOTAL OPERATING</u>	-	306.2	-	-	-	-
<u>CAPITAL</u>	-	-	-	-	-	-
<u>REVENUE</u>	-	-	-	-	-	-

FUNDING: (Thousands of Dollars)

GENERAL FUND	-	-	-	-	-	-
FEDERAL FUNDS	-	-	-	-	-	-
OTHER	-	306.2	-	-	-	-
<u>TOTAL</u>	-	306.2	-	-	-	-

POSITIONS:

FULL-TIME	-	4	-	-	-	-
PART-TIME	-	3	-	-	-	-
TEMPORARY	-	-	-	-	-	-

ANALYSIS: Attach a separate page for analysis.

(See attached)

Prepared By: Ervin B. Jones, Director
 Division: Administrative Services

Phone: 465-2313

Date: 2/25/85

Approved by Commissioner: Milt Barber Acting
 Agency: Revenue

Date: 3-1-85

Distribution (by Agency preparing fiscal note):

Legislative Finance
 Legislative Sponsor
 Requestor
 Office of Management and Budget
 Impacted Agency(ies)

HB 210
Fiscal Note Analysis
Department of Revenue
PFD BRU - Administrative Services Component
February 25, 1985

As can be seen from the attached analysis of the bill, section by section, the primary impact on the Administrative Services component of the Permanent Fund Dividend BRU is going to be in Data Processing. This impact can be summarized in three areas:

- 1) The need to completely re-program the 1985 PFD system, with its approximately one hundred DP programs, both batch and on-line. These programs are for both the IBM mainframe and for the WANG VS system that is used in Anchorage and in Juneau.
- 2) The dramatic changes wrought by this bill will push the Department to combine all years in some fashion. Carrying multiple, separate systems on-line, and maintaining these separate systems has become very costly in terms of data processing resources. Revenue has been looking at a modified system that allows both look-up and interaction with prior year accounts, but the addition of the annuity based 1986 system will severely complicate that system design.
- 3) The addition of the annuity choice and its related edit requirements will impact the data entry section.

The incremental costs of performing these functions between the assumed effective date of approximately July 1, 1985 and the end of FY86 is estimated as follows:

Personal Services

- 1) Reprogram for 1986 PFD system
 - 1 Analyst/Programmer V, R21, @ \$4,653.05/Mo
including salary and benefits for 12 months \$55,836
 - 1 Analyst/Programmer IV, R19, @ \$4100.75/Mo
including salary and benefits for 12 months \$49,209
- 2) Project to consolidate 1986 system with prior four years (online, same as above)
 - 1 Analyst/Programmer V, R21, @ \$4,653.05/Mo
including salary and benefits for 12 months \$55,836
 - 1 Analyst/Programmer IV, R19, @ \$4100.75/Mo
including salary and benefits for 12 months \$49,209
- 3) Data capture of additional data required on PFD applications.
 - 3 Data Entry Clerk I's, R8, @ \$2,120.77/Mo
including salary and benefits, for 3 Mos each \$19,087

HB 210
Fiscal Note Analysis
Department of Revenue
PFD BRU - Administrative Services Component
February 25, 1985

TOTAL Personal Services		\$229,200
<u>Travel</u> (all 3 projects)	\$2,500	
To pay travel/per diem costs of system analysts attending meetings in Anchorage and Juneau to map out the needed changes to the current PFD system.		
TOTAL Travel		\$2,500
<u>Contractual</u>		
1) To contract with Wang Labs, Inc to modify the existing garnishment system for PFD's. The Analyst/Programmer who built the original garnishment system currently works for Wang Labs, Inc as a systems consultant. Assuming he was available, he could redesign the system much faster than any other programmer available. This amount is calculated at \$80/hour X 8 hour days X 5 day weeks X 16 weeks	=	\$51,200
2) 4 Wang 4250 workstations rented for 12 Mos, @ \$398/Mo including emulator boards @ \$805 each, so they may be used as IBM terminals or Wang terminals	=	\$22,300
TOTAL Contractual		\$73,500
Supplies		1,000
TOTAL Administrative Services Cost		\$306,200

DEPARTMENT OF REVENUE
Analysis of
HB 210
2/25/85

The proposed legislation directly impacts four divisions within DOR:

- Division of Administrative Services
- Division of Enforcement
- Division of Treasury
- Division of Public Services

For purposes of convenience, we have consolidated our responses into categories instead of along division lines:

- I. Introduction - The Annuity Program
- II. Section-by-Section Analysis of Amendments to AS 43
- III. Proposed Amendments
- IV. Division(s) Fiscal Notes

I
Introduction
The Annuity Program

Annuity Program

Under the annuity program established by HB 210, an eligible Alaska resident under the age of 65 as of January 1, 1986 may forego all or a portion, but not less than 25%, of their permanent fund dividend in exchange for a credit to an individual annuity account. Upon reaching the age of 65, that person will receive a monthly annuity for the remainder of their life that is based on the accumulated value of their annuity account, including interest, at age 65.

As it does currently, the Enforcement Division of the Department of Revenue will determine eligibility for a dividend. Under HB 210 the division of Administrative Services will provide to the Department of Administration, the amount, if any, each resident's annuity account would be credited as a result of electing such credit rather than a cash dividend. The total of such credits will be transferred to the annuity investment fund from the dividend fund.

The Treasury Division of the Department of Revenue will invest the annuity investment fund. Investments permitted are the same as those of the Public Employees Retirement Fund except that the fund may also be invested in commercial insurance contracts. *Periodically, the Treasury Division will notify the Department of Administration of the income realized by the fund. The Department of Administration will allocate this as a pro-rata credit to each person's annuity account based on the balance in their account.

At age 65, a monthly annuity payment will be established for each individual. It will be determined by either the annuity available on the market which can be purchased with the amount in the annuitant's account or an amount determined by the Department of Administration based on then current interest rates, mortality tables, and amounts on the account if an "in-house" option is chosen to meet the liability for annuity payments. Under the "in-house" option the State would continue to manage the investment of the funds in annuitants' accounts at age 65 and thereafter.

Each year, the legislature may appropriate from the annuity investment account the amount required to make the monthly payments to annuitants who are 65 or older. The amounts required will be transferred to the Department of Administration which will make the payments.

The appropriation could be of "the amount required by AS 43.23.130" or the Department of Administration could provide an estimate each year which would be inexact due to deaths during the year of annuitants or those who would become annuitants in that year.

Comments

The private insurance option transfers from the fund the risk of inadequate earnings on post-65 annuitants' accounts to cover liabilities for payments. Of course the risk is not totally avoided since there is always some credit risk that the insurer will fail.

However, by incorporating the private insurance option into the investment fund as an investment, a conflict can arise with AS 43.23.110(c) which required crediting annuity accounts with investment fund earnings. If average fund rate-of-return is less than that on the insurance contracts, full payment of monthly annuities to those over 65 cannot be made while also crediting under-65 accounts at the average rate of return. This is because in this case the average rate of return on under-65 accounts would be higher than the actual returns. Of course, the credits can be made since they don't require cash payment and over time the problem may be eliminated by years on which average fund earnings exceed insurance contract rates of return.

A more definitive solution might be to credit under-65 accounts only with earnings net of annuity payments, to establish separate funds for those over and under 65, or to make the insurance contracts simply contracts of the Department of Administration and not investments of the annuity investment funds. In the case of "in-house" management, similar conflict would exist AS 43.23.110(c) when assumed rates of return and mortality differ from that realized.

The other major aspect of the annuity program which may present technical problems is the allocation from "front-loading" in AS 43.23.110(b)(2) and (3). If the base amount in (b)(2) is a separate

appropriation or allocation in the legislation appropriating the "front-loading", then that base amount can be determined. In any event, (b)(3)'s derivation remains ambiguous.

II

Alaska Department of Revenue
Section by Section Analysis of HB 210
February 25, 1985

- Section 1: Intent section, no effect on Department of Revenue except that paragraph (4), lines 3-5 sets up the relationship of two choices: annuity is the default unless applicant chooses cash. This affects form design and programming.
- Section 2: Amends AS 43.23.005(c). Replaces the word "payment" with "dividend," for consistency reasons. There is no direct effect on the Department of Revenue.
- Section 3: Amends AS 43.23.005 by establishing alternatives for PFD applicants:
- a) If person is 65 or older on December 31, 1985, there is only one choice - 100% cash dividend.
 - b) If person is under 65 on December 31, 1985, there are two basic choices:
 - 1) 100% cash.
 - 2) At least 25% cash, and between 1 and 75% annuity.
- Section 4: Amends AS 43.23.015(a). This change would appear to have no effect on the Department of Revenue unless the intent is to limit the Department of Revenue's ability to adopt regulations defining residency, etc., as opposed to just establishing the process.
- Section 5: Amends AS 43.23.015(b) by changing the affidavit printed on the application, so that the applicant signs a statement that he or she understands that they will lose all dividends and interest credited to his/her annuity account. It should be amended to say the person also loses all the legislative appropriations credited under AS 43.23.110 (Section 16 of this bill). This represents a major forms change, and more importantly, creates substantial collection problems leaving many questions unanswered. For example, it is clear that the Department of Revenue can use collection procedures to collect money paid to applicants as cash dividends and within the limits of Section 10, as well as collect funds transferred to the Department of Administration based on an option for annuity, however what about:

- 1) Collecting annuities already paid to a person over 65? Who collects it and how?
- 2) If Revenue attempts to retrieve money from the Department of Administration after conviction or discovery of error, which agency goes after money from the annuitant? Under what provision of law? What if there aren't enough funds in the dividends account?

Section 6: Amends AS 43.23.015(.) in an attempt at consistency. But given the extreme difficulties that exist in administering a trust for persons in custody of a public agency (typically children in custody of the Department of Health & Social Services) and the animosity that is generated in the parents, giving a state agency the option of irrevocably placing a custodial person's dividend in an annuity account seems certain to generate extreme animosity from those parents and potential law suits for the recovery of the funds.

Section 7: Amends AS 43.23.015(f) for consistency with the new concept of the PFD annuity. It is important to note that this does nothing to correct the potential problem mentioned in the analysis of Section 6. Otherwise there is no effect on the Department of Revenue.

Section 8: Amends AS 43.23.015 by adding a paragraph directing the Department of Revenue to provide an option on the PFD application. For consistency's sake, the wording on line 16-17 should be changed to reflect the wording of the option as given in Section 3. Section 8 implies only two choices: 100% cash or 100% annuity. This doesn't square with Section 3, which provides that every applicant receives at least 25% of the dividend value in cash. It should also be noted that the use of the term "permanent fund dividend" on line 17 in juxtaposition to the term "cash" implies that the term "permanent fund Dividend" is defined as meaning annuity credit. This is not the definition provided in Section 15. The only effect on the Department of Revenue of this section is to modify the form and explain the choices to the public.

Section 9: Amends AS 43.23.035 to reflect the new concept of the PFD annuity option. It is unclear as to whether "additional credits" on line 24 means an allocation of future legislated appropriations and/or interest accrued to original annuity credits. The language here should be coordinated with the language in Section 5. Again, there are enforcement/collection problems. What if annuity payments have already started and there is not enough left to pay back all the erroneously credited dividends? How is the balance collected, and by whom? To what fund(s) are collections credited?

Section 10: Amends AS 43.23.035 to provide a mechanism for the Department of Revenue to collect dividends erroneously credited to the annuity investment account. This section also distinguishes between the remedy available to the Department of Revenue when the error is the fault of the state and when the error is the fault of the individual. It is difficult to evaluate which date starts the clock - date credited, or date discovered.

Section 11: Amends AS 43.23.055 to redefine the duties of the Department of Revenue to reflect the new concept of a PFD annuity option. Lines 19-20 again implies two choices - 100% cash or 100% annuity. Under the provisions of Section 3, everyone receives at least 25% cash. Lines 11-13 on page 6 requires the Department of Revenue to provide information to the Department of Administration necessary to maintain the individual annuity account records and administer the annuity program. It would appear that this information exchange would consist of the following:

- 1) Each week, starting with the first PFD payment run in October, the Department of Revenue would notify the Department of Administration (via a computer tape) of those applicants who came up for payment and who chose that a percentage of their dividend be credited to their annuity account. This will allow the Department of Administration to credit the account with the proper amount and as of the date on which the applicant would have otherwise been paid cash. This reporting will go on weekly as long as the Department of Revenue is making payments from that particular year's file.
- 2) On a regular basis, the Department of Revenue would have to provide the Department of Administration with the interest rate that reflects the earnings of the annuity investment fund.
- 3) On a case by case basis over a 10-year period the Department of Revenue - Enforcement would notify the Department of Administration of erroneous payments and seek reimbursement from the annuity investment fund.

Sections 12 & 13: Amend AS 43.23.065 to reflect the new concept of a PFD annuity option. The general effect of Sections 12 and 13, taken together, seems to be that the portion of a dividend which is taken as a credit to an annuity is not subject to levy, execution, garnishment, attachment, or other remedies for the collection of debt. As a statute change unrelated to the annuity concept, Section 12 provides for 100% attachment of a cash dividend to satisfy a court-ordered restitution under AS 12.55.045 - 12.55.051 or 12.55.100. It is important that the court order will serve to attach

the dividend only if served on the Department of Revenue timely, as in the case of any other attachment order (CSED, IRS, etc.). Section 13 goes further by providing that in the case of a CSED arrearage or in the case of a civil judgement or order of restitution, the Department of Revenue or the Alaska courts, respectively, may require the defendant to take his/her entire PFD in cash. First of all, it is important to note that neither the Department of Revenue nor the court can force a person to apply for a dividend, but can force a selection of cash once the applicant has filed. There are two potential problems with Section 13:

- 1) The Department of Revenue cannot determine that an applicant meets the criteria of Section 13 until either CSED or a court agency serves an attachment order on the Department of Revenue - Enforcement, and in the case of CSED, indicating a past-due debt, and
- 2) Given that the overall thrust of Sections 12 and 13 is to exempt dividends selected as annuity credits from attachment, in the case of a person who owes (under Section 13) less than the amount of the total dividend, and originally chose the annuity option, it would seem that only an amount necessary to satisfy the debts under both the proposed AS 43.23.065(b) and (c) could be converted to the cash option, with the residual amount still protected from general attachment. This needs to be clarified.

Section 14: Amends AS 43.23.075 to reflect the new concept of a PFD annuity option. There is no effect on the Department of Revenue.

Section 15: Amends AS 43.23.095(b) to change the definition of "permanent fund dividend" to include the PFD annuity option. There is no effect on the Department of Revenue, save substantial changes to existing regulations.

Section 16: This section establishes the Annuity Program, to be administered by the Department of Administration. Although this section of the bill has very little impact on the Department of Revenue - PFD BRU, the following thoughts are offered for consideration:

- 1) AS 43.23.110(a), as proposed, provides for the gross amount selected as annuity credits to be transferred from the PFD fund to the annuity investment fund annually. As previously noted, the Department of Revenue could provide a magnetic file weekly as annuity participants come up for payment. The question is when does the interest envisioned in the proposed AS 43.23.110(c) begins to accrue: at payment of the residual cash dividend, or at some annual date upon transfer of the gross amount.

2) AS 43.23.110(b), as proposed, provides that the Legislature may appropriate additional funds to the annuity investment fund. Since this appropriation will likely be made during January - May of a given year, it should be clarified as to whether the appropriation is to be allocated between annuity participants of that same calendar year, or amongst those who selected the annuity option for the prior calendar year. If as the bill implies, the former is the case, then the Legislature will be making an appropriation without prior knowledge of the number of participants or the total amount of dividends selected as annuity credits. The applications are filed between April 1 - June 30 and the information is not on computer file until approximately July 31.

AS 43.23.110(b)(1), as proposed, appears to have the same constitutional flaws that caused the Legislature to include the children of Alaska in the PFD program in 1982.

AS 43.23.110(b)(2), as proposed, does not specify what portion of the appropriation should be used as the "base" amount. Also there needs to be definitions of the formula for determining the base amount, i.e. half the appropriation divided by the number of eligible annuitants.

AS 43.23.110(b)(3), as proposed, is a very confusing paragraph and makes no comprehensible sense. The formula for showing the appropriation must be clarified and simplified to the point that it can be easily explained to the public, in written form in the application booklet, in person during the required rural assistance program, and to the tens of thousands of Alaskans who will be asking the Department of Revenue's Public Services Assistance Centers for a lucid explanation.

AS 43.23.110(b)(4), as proposed, again implies that a person has an option of opting for 100% annuity, in contradiction of Section 3.

AS 43.23.110(c), as proposed, requires the Department of Revenue to provide the Department of Administration with the appropriate interest rate. The question unanswered is how often? The other implication is that the monies in the annuity investment fund are not to be co-mingled with other monies in the General Fund, but truly invested as a separate fund. This needs to be nailed down.

AS 43.23.130, as proposed, describes the benefit PFD applicants would receive in exchange for the option of receiving their whole dividend in cash, versus accepting up to 75% of the dividend in annuity credit. For this reason, it is extremely important that this section be very clear

to the reader, and it is. In (f) of this section, there appears to be an attempt to shelter the original dividend given up, in part, for an annuity credit, from taxation by the federal government as income in the year the dividend was available in cash. The doctrine of "constructive receipt" would hold the dividend taxable in the current year and this will have to be pointed out to recipients of the dividend at the time their dividend is paid, whether it is paid in credits or in cash.

Section 22: Provides an implementation schedule for the provisions of this bill and makes the Act applicable to PFD years 1986 and thereafter. This defines the time period in which the Department of Revenue has to accomplish all of the necessary program changes. The Department of Revenue will have from the date this bill becomes law until March 31, 1986. This accelerated schedule will be costly and will make it very difficult to get everything on line by the 1986 filing period.

Section 23: Provides an effective date.

III

Alaska Department of Revenue
Suggested Amendments to HB 210
February 25, 1985

Submitted by Division of Administrative Services:

Eliminate Internal Contradictions Regarding Cash vs Annuity

1. Section 1 and Section 3 are contradictory as to the options available and should be modified.

Page 2, lines 3 - 5 implies that the entire dividend is applied to the annuity account absent a conscious election by the applicant.

Page 2, lines 22-24 says that the only choice other than 100% cash is 25% or more cash and between 1 and 75% annuity. Per Section 3, there does not appear to be a 100% annuity option.

2. Page 4, lines 16-17 should be amended to reflect the same wording of Section 3, to eliminate the contradiction regarding the available options.
3. Page 5, lines 17-20 like Section 1, implies only two choices: 100% cash or 100% annuity. This should be amended to square with Section 3.

Making Annuity/Cash Election Irrevocable

4. It is important that the election be binding and irrevocable. If people change their mind, make a mistake, or whatever, there should be no opportunity to change election. Otherwise, the cost of this program will go up dramatically.

Limit Choice

5. Page 2, lines 19-25 should be amended to limit the choice of hybrid payments to:
 - a) 100% cash,
 - b) 25% cash, 75% annuity credit,
 - c) 50% cash, 50% annuity credit, or
 - d) 75% cash, 25% annuity credit.

As it currently reads, there are at least 76 real options, significantly complicating the administration of the program.

Avoidance of Debts to State Agencies

6. Page 7, line 13 should be amended by adding a new subsection (d) to include debts to a state agency as a valid reason for compelling an applicant to elect a cash dividend.

STATE OF ALASKA 1985 LEGISLATIVE SESSION
FISCAL NOTE

Revision Date _____

REQUEST

Bill/Resolution No: HB 210
 Title: An Act amending the longevity bonus program and the permanent fund dividend program, establishing an annuity program
 Requestor: House State Affairs
 Sponsor: Taylor and Jenkins

FISCAL DETAIL

Agency Affected: Revenue
 Program Category Affected: General Government
 BRU, Program of Subprogram(s) Affected: Permanent Fund Dividend - Enforcement
 Date of Request: February 20, 1985

EXPENDITURES/REVENUES: (Thousands of Dollars)

	FY 85	FY 86	FY 87	FY 88	FY 89	FY 90
OPERATING						
100 PERSONAL SERVICES	-	-	-	-	-	-
200 TRAVEL	-	-	-	-	-	-
300 CONTRACTUAL	-	-	-	-	-	-
400 SUPPLIES	-	-	-	-	-	-
500 EQUIPMENT	-	-	-	-	-	-
600 LANDS & STRUCTURES	-	-	-	-	-	-
700 GRANTS, CLAIMS	-	-	-	-	-	-
800 MISCELLANEOUS	-	-	-	-	-	-
TOTAL OPERATING	-	-0-	-0-	-0-	-0-	-0-
CAPITAL	-	-	-	-	-	-
REVENUE	-	-	-	-	-	-

FUNDING: (Thousands of Dollars)

GENERAL FUND	-	-	-	-	-	-
FEDERAL FUNDS	-	-	-	-	-	-
OTHER	-	-	-	-	-	-
TOTAL	-	-0-	-0-	-0-	-0-	-0-

POSITIONS:

FULL-TIME	-	-	-	-	-	-
PART-TIME	-	-	-	-	-	-
TEMPORARY	-	-	-	-	-	-

ANALYSIS: Please see attached analysis.

Prepared By: Thomas C. Williams
 Division: Enforcement Division

Phone: 465-2366
 Date: February 25, 1985

Approved by Commissioner: Matt Baker Acting
 Agency: Revenue

Date: 3-1-85

Distribution (by Agency preparing fiscal note):

- Legislative Finance
- Legislative Sponsor
- Requestor
- Office of Management and Budget
- Impacted Agency(ies)

Alaska Department of Revenue
Enforcement Division
Analysis of HB 210
February 25, 1985

The fiscal impact of HB 210 is \$-0- given the following assumptions.

1. Garnishment EDP programming changes can be accomplished at least three months before the 1986 payment schedule begins.
2. Orders of Restitution are served on the Division just as any other garnishment document, such as writs or Orders to Withhold.
3. Language is included that assures a creditor may not defeat a State agency by electing an annuity. If this is not done, the potential impact is a loss of revenue. Although not readily estimateable it is not anticipated to be significant.
4. Deposit and fund crediting procedures for collections of erroneously paid annuities are kept simple and/or allocation between funds are determined by the Department of Administration.

STATE OF ALASKA 1985 LEGISLATIVE SESSION
FISCAL NOTE

Revision Date

REQUEST

Bill/Resolution No: HB 210
 Title: Longevity Bonus, Permanent Fund Dividend, and Annuity Programs
 Sponsor: Taylor
 Requestor: House State Affairs
 Date of Request: February 20, 1985

FISCAL DETAIL

Agency Affected: Department of Revenue
 Program Category Affected: _____
 BRU, Program of Subprogram(s) Affected: Treasury

EXPENDITURES/REVENUES: (Thousands of Dollars)

	FY 85	FY 86	FY 87	FY 88	FY 89	FY 90
<u>OPERATING</u>						
100 PERSONAL SERVICES	-	-	-	-	-	-
200 TRAVEL	-	-	-	-	-	-
300 CONTRACTUAL	-	9.3	11.1	14.8	19.3	24.7
400 SUPPLIES	-	-	-	-	-	-
500 EQUIPMENT	-	-	-	-	-	-
600 LANDS & STRUCTURES	-	-	-	-	-	-
700 GRANTS, CLAIMS	-	-	-	-	-	-
800 MISCELLANEOUS	-	-	-	-	-	-
<u>TOTAL OPERATING</u>	-	9.3	11.1	14.8	19.3	24.7
<u>CAPITAL</u>	-	-	-	-	-	-
<u>REVENUE</u>	-	-	-	-	-	-

FUNDING: (Thousands of Dollars)

GENERAL FUND	-	-	-	-	-	-
FEDERAL FUNDS	-	-	-	-	-	-
OTHER Annuity Investment Fund	-	9.3	11.1	14.8	19.3	24.7
<u>TOTAL</u>	-	9.3	11.1	14.8	19.3	24.7

POSITIONS:

FULL-TIME	-	-	-	-	-	-
PART-TIME	-	-	-	-	-	-
TEMPORARY	-	-	-	-	-	-

ANALYSIS: See attached analysis.

Prepared By: Milt Barker MB
 Division: Treasury

Phone: 465-2350
 Date: February 21, 1985

Approved by Commissioner: Milt Barker A-72:41
 Agency: Department of Revenue

Date: 3-1-85

Distribution (by Agency preparing fiscal note):

- Legislative Finance
- Legislative Sponsor
- Requestor _____
- Office of Management and Budget
- Impacted Agency(ies)

HB 210
Fiscal Note Analysis

Costs in this fiscal note are based on the following projected balances of the Annuity Investment Fund:

<u>Fiscal Year</u>	<u>Average Fund Balance (\$ Millions)</u>
1986	\$ 53
1987	88
1988	159
1989	244
1990	347

These projections assume three years of front-loading, 30% participation by eligibles, and 12% rate of return on investments.

Based on these average balances, the following costs would be incurred (\$000):

<u>Fiscal Year</u>	<u>Securities Custody</u>
1986	9.3
1987	11.1
1988	14.8
1989	19.3
1990	24.7

Distribution (by Agency preparing fiscal note):

Legislative Finance

Legislative Sponsor

Requestor

Office of Management and Budget

Impacted Agency(ies)

STATE OF ALASKA 1985 LEGISLATIVE SESSION
FISCAL NOTE

Revision Date

REQUEST

Bill/Resolution No: HB210
 Title: An Act Amending the Longevity Bonus Program & Permanent Fund Dividend Program Establishing an Annuity Program and Providing an Effective Date.
 Sponsor: Taylor and Jenkins
 Requestor:
 Date of Request: February 20, 1985

FISCAL DETAIL

Agency Affected: Revenue
 Program Category Affected: Revenue Collections

BRU, Program or Subprogram(s) Affected: Public Services

EXPENDITURES/REVENUES: (Thousands of Dollars)

	FY 85	FY 86	FY 87	FY 88	FY 89	FY 90
<u>OPERATING</u>						
100 PERSONAL SERVICES	-	78.3	164.3	174.2	184.7	195.8
200 TRAVEL	-	13.5	25.2	27.2	28.8	31.1
300 CONTRACTUAL	-	404.5	414.6	138.5	138.7	139.0
400 SUPPLIES	-	2.0	.8	.9	1.0	1.1
500 EQUIPMENT	-	5.0	-0-	-0-	-0-	-0-
600 LANDS & STRUCTURES	-	-	-	-	-	-
700 GRANTS, CLAIMS	-	-	-	-	-	-
800 MISCELLANEOUS	-	-	-	-	-	-
<u>TOTAL OPERATING</u>	-	503.3	604.9	340.8	353.2	367.0
<u>CAPITAL</u>	-	-	-	-	-	-
<u>REVENUE</u>	-	-	-	-	-	-

FUNDING: (Thousands of Dollars)

GENERAL FUND	-	-	-	-	-	-
FEDERAL FUNDS	-	-	-	-	-	-
OTHER	-	503.3	604.9	340.8	353.2	367.0
<u>TOTAL</u>	-	503.3	604.9	340.8	353.2	367.0

POSITIONS:

FULL-TIME	-	5	5	5	5	5
PART-TIME	-	-	-	-	-	-
TEMPORARY	-	-	-	-	-	-

SOURCE OF FUNDS TO OFFSET FISCAL IMPACT OF BILL:

ANALYSIS: See attached.

Prepared By: Sally Smith, Director
 Division: Public Services

Phone: 465-2392

Date: February 22, 1985

Approved by Commissioner: Milt Barber, Acting
 Agency: Revenue

Date: 3-1-85

REPRESENTATIVE KATIE HURLEY'S REMARKS
LONGEVITY BONUS HEARINGS - ANNUITY PROPOSALS
3/12/85

I WOULD NOW LIKE US TO SPEND SOME TIME DISCUSSING SOME ADDITIONAL POLICY CHOICES THAT PERTAIN ONLY TO THE ANNUITY BILLS. THESE ARE NOT THE TYPE OF ISSUES THAT "EXPERTS" CAN ADVISE US ON SO WE NEED TO DISCUSS THEM AMONG OURSELVES.

ONE COMMON UNDERCURRENT OF THE TESTIMONY WE HAVE HEARD TO DATE ON THE ANNUITY PROPOSALS IS WHETHER OR NOT PARTICIPATION IN THE PLAN IS ENCOURAGED. I THINK ONE OF OUR PRIMARY CONCERNS SHOULD BE WHO WILL PARTICIPATE. IT APPEARS THAT THE COST OF THE PROGRAM -- EXCEPT FOR THE DOLLARS NEEDED TO SUBSIDIZE OR FRONTLOAD IT --- IS NOT AFFECTED BY HOW MANY PEOPLE PARTICIPATE. BUT PERHAPS THE SUCCESS OF THE PROGRAM WILL BE AFFECTED IF ONLY A SMALL NUMBER OF ALASKANS PARTICIPATE. WE HAVE HEARD TESTIMONY THAT SUGGESTS ONLY HIGHER INCOME ALASKANS WILL PARTICIPATE BECAUSE POORER INDIVIDUALS NEED ALL THE CASH THEY CAN GET. ALSO, THE TESTIMONY COMPARING THESE PROPOSALS TO PRIVATE SECTOR OPTIONS APPEARED TO QUESTION WHETHER THE HIGHER INCOME WOULD BE INTERESTED IN THE ANNUITY. SO, WHAT IS THE ANSWER TO THE PARTICIPATION QUESTION? WHO WILL PARTICIPATE IN THE ANNUITY PLAN? WHO DO WE WANT TO ENCOURAGE TO PARTICIPATE? WILL THE PROGRAM BE A SUCCESS IF ONLY A SMALL NUMBER OF AFFLUENT ALASKANS PARTICIPATE?

ANOTHER ISSUE THAT I THINK WE NEED TO DISCUSS IS WHETHER THE ANNUITY SHOULD BE VOLUNTARY OR MANDATORY. IF IT IS MANDATORY, OUR PARTICIPATION PROBLEM IS SOLVED. SHOULD THE LEGISLATURE MAKE THIS DECISION FOR THE PEOPLE? SHOULD THIS QUESTION BE PUT TO THE VOTERS? FOR THAT MATTER, SHOULD THE WHOLE ISSUE OF THE FUTURE OF THE BONUS AND/OR THE FUTURE OF THE DIVIDEND PROGRAM BE PUT TO A VOTE?

WE SHOULD ALSO DISCUSS SUBSIDIZATION OR FRONTLOADING. SHOULD WE MAKE THE PROGRAM MORE ATTRACTIVE BY SUBSIDIZING IT? DOES THIS CONFLICT WITH THE STATED PURPOSE OF THE ANNUITY OPTION, "TO SUBSTITUTE PRIVATE THRIFT FOR PUBLIC LARGESSE?" WHAT ARE THE ADVANTAGES AND DISADVANTAGES OF USING THE UNDISTRIBUTED INCOME ACCOUNT TO SUBSIDIZE THE PROGRAM? IS THIS AN APPROPRIATE USE FOR THE UNDISTRIBUTED INCOME ACCOUNT? SHOULD THE LEGISLATURE OR THE VOTERS DECIDE THIS?

WHETHER OR NOT TO INCLUDE THE COLA IN THE LEGISLATION IS ALSO A POLICY DECISION, I THINK. SHOULD WE ESTABLISH A 3% COLA IN THE PROGRAM? HOW DOES IT REFLECT REAL INFLATION PATTERNS? SHOULD WE DECIDE THIS ISSUE FOR FUTURE LEGISLATURES?

IF IT IS TRUE THAT POORER ALASKANS CANNOT AFFORD TO INVEST IN THE ANNUITY OPTION, HOW SHOULD WE DEAL WITH THIS PROBLEM? SHOULD WE SEPARATE CONSIDERATION OF THE BONUS PHASE OUT FROM CONSIDERATION OF A STATE RETIREMENT PROGRAM? IN OTHER WORDS, SHOULD WE PHASE OUT THE PROGRAM IN A MANNER THAT IS MORE BENEFICIAL TO POOR ELDER ALASKANS AND DIVORCE THE PHASE OUT FROM CONSIDERATION OF THE ANNUITY PROGRAM?

EVEN APART FROM CONSIDERING THE IMPACT ON THE POOR, IS IT MORE APPROPRIATE TO CONSIDER PHASING OUT THE BONUS AND ESTABLISHING A STATE RETIREMENT PROGRAM AS TWO SEPARATE ISSUES? SHOULD

RESOLVING THE BONUS PROBLEM BE TIED TO CHANGING THE PERMANENT FUND DIVIDEND PROGRAM? PERHAPS THIS GETS AT THE HEART OF THE ISSUE --- IS THE PROPOSED ANNUITY PLAN REALLY A CONTINUATION OF THE BONUS PROGRAM WITH A DIFFERENT FUNDING SOURCE OR IS IT A WAY OF MODIFYING THE PERMANENT FUND DIVIDEND PROGRAM THAT SHOULD BE CONSIDERED SEPARATELY?

I'M SURE THAT I HAVE NOT TOUCHED ON ALL THE ISSUES INVOLVED IN MAKING OUR DECISION ON THE ANNUITY OPTION BUT I HOPE I HAVE SPARKED YOUR INTEREST IN SOME OF THEM. LET'S NOW GET ON WITH OUR DISCUSSION.

Basic background information
on ANNUITIES

Fundamentals of Private Pensions

Dan M. McGill
University of Pennsylvania

In collaboration with

Donald S. Grubbs, Jr.
George B. Buck Consulting Actuaries, Inc.

1984 Fifth Edition

Published for the
Pension Research Council
Wharton School
University of Pennsylvania

by

RICHARD D. IRWIN, INC.
Homewood, Illinois 60430

Francis C. Bronson

John W. Patterson
Pension Plans—

James E. McNulty, Jr.

Joseph J. Melone
Griffin, Jr. and

McGill

William E. McKelvey
Maurice E. McDonald
D. Hall and

Complementary?

ers

McGill (ed.)
Vinklevoss and

nation of benefit amounts.
ns of private employers.

Intermediate positions may
the employee should receive
those that would have been
without adjustment for a
benefit credits. Under this
retirement benefits would be
rate and the benefit of
it and converted into an an-
e's attained age. A variation
benefit of survivorship. An-
of the normal retirement ben-
actual retirement date from
benefit payments with interest
these adjustment procedures
it that is the actuarial equiv-
the normal retirement date.
not benefit through actuarial
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were his normal retirement
his service and compensation
men, one age 45 and the
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tively, they will receive the
Other methods produce un-
Some plans modify this ap-
is of the employee's average
ceding his normal retirement

ed retirement provisions may
l actuarial considerations but
r he wants to encourage or

it of survivorship.

Manner of Payment

Implicit in most pension plans is the payment of a retirement benefit that continues throughout the remaining lifetime of the retired employee.⁸ The plan may provide various collateral benefits, but underlying the whole scheme must be the promise of a life income to the participant upon his retirement. If this promise is underwritten or guaranteed by a life insurance company, the life income will be provided in the form of an annuity contract of some type. If the plan is funded through a trust, the benefits may be provided through an annuity contract purchased from an insurance company, probably at the time of the employee's retirement, or they may be paid directly from the trust fund. A series of annual or monthly payments is referred to as an "annuity" or "annuity benefit," whether or not it is insured by a life insurance company.

Types of Annuities

Several forms of annuities are available for the disbursement of pension benefits. Classified broadly, life annuities may be of the single life or joint life variety, and within that classification they may be either of the pure or refund type. As indicated by its title, a single life annuity is one which is based on only one life. The pure form of single life annuity, usually referred to as "straight-life annuity," provides periodic, usually monthly, income payments that continue as long as the annuitant lives and terminate upon his death. The annuity is considered fully liquidated upon the death of the annuitant, and no guarantee is given that any particular number of monthly payments will be made. Because of the absence of any benefit after death, this type of single life annuity provides the largest monthly income per dollar of purchase price outlay.⁹

⁸The Internal Revenue Service requires a qualified pension plan to make benefits available in the form of an annuity, either a life annuity or an annuity for a period of years. Treas. Reg. 1.401-1(a)(1)(i).

⁹In this generalized description of annuities, the monies committed to the annuity will be called the price or purchase price, following insurance terminology. Under a pension plan, assets equal to the actuarial reserve for benefits payable to a retiring employee are set aside, in theory or in fact, to be liquidated in accordance with a stipulated form of annuity.

*"Life Annuity
Certain and
Continuous"*

The annuity may promise that a certain number of monthly payments will be made whether the annuitant lives or dies, with payments to continue, of course, if the annuitant lives beyond the guaranteed period. In insurance circles, this type of annuity is referred to as a "life annuity certain and continuous," and the annuitant may elect 60, 120, 180, or 240 guaranteed installments.¹⁰ The cost of the annuity increases with the number of guaranteed installments, since life contingencies are not involved during the guaranteed period.

*Installment
Refund
Annuity*

*Cash
Refund
Annuity*

*Modified
Cash Refund
Annuity*

The refund type of single life annuity includes any annuity that guarantees to return in one manner or another a portion or all of the purchase price of the annuity. An "installment refund annuity" promises that, if the annuitant dies before receiving monthly payments equal to the purchase price of the annuity, the payments shall be continued to the annuitant's beneficiary until the full cost has been recovered. If the contract promises, upon the death of the annuitant, to pay to the annuitant's beneficiary in a lump sum the excess (if any) of the purchase price of the annuity over the sum of the monthly payments, it is designated a "cash refund annuity." The only difference between the "cash refund annuity" and the "installment refund annuity" is that, under the former, the unliquidated purchase price is refunded in a lump sum at the time of the annuitant's death; whereas, in the latter case, the monthly installments are continued until the purchase price has been recovered. These two types of annuities are more costly than the straight-life annuity, with the "cash refund annuity" being somewhat more costly than the "installment refund annuity" because of the loss of interest. A "modified cash refund annuity" promises to refund only a portion of the purchase price, usually the accumulated employee contributions.

*Joint and Survivor
Annuity*

The joint and survivor annuity provides periodic payments as long as either of two persons shall live. For most combinations of ages, this is the most expensive of all annuity forms. This type of contract is primarily designed to provide old-age income to a husband and wife. The income may be reduced upon the death of either annuitant to either one half or two thirds of the original amount, on the theory that the survivor does not require as large an income as do the two annuitants. Under some plans, the reduction is made when either annuitant dies. Under others, the reduction is made only if the retired participant dies first. This arrangement is often called a "contingent annuitant option."

¹⁰Such a range of options is not usually provided under a pension plan.

Normal and Optional Annuity Forms under Pension Plans

The benefits under a pension plan, and their cost, are calculated on the assumption that the benefit payments will conform to a particular pattern. This pattern is known as the "normal annuity form," and it is the third component of the benefit formula, the other two being the benefit amount and the age at which the payments will commence. The normal annuity form specified in most noncontributory plans is the straight-life annuity, although it is not unusual to guarantee a certain number of installments. Contributory plans usually adopt a modified cash refund annuity. This form promises that, should the employee die before receiving retirement benefits equal to the accumulated value at retirement of his contributions, with or without interest, the difference between his benefits and this accumulation will be refunded in a lump sum to his estate or to a designated beneficiary. Some contributory plans prescribe a life annuity with payments guaranteed for 5 or 10 years, either form of which will, in the typical case, assure the return of the employee's accumulated contributions.

Pension plans have traditionally given the participant the option of electing, before or at retirement, and at his own expense, an annuity form different from that prescribed in the plan document. The range of options has differed, some plans offering a wide choice and others being rather restrictive; but it has been customary to offer some form of joint and survivor annuity so the participant might assure his spouse of a life income in some amount.

All pension plans must provide that retirement benefits payable as a life annuity to an employee married to his current wife for at least one year will be automatically paid in the form of a "qualified" joint and survivor annuity unless the participant elects otherwise.¹¹ A "qualified" joint and survivor annuity is defined as a type that provides income to the surviving spouse in an amount equal to at least one half of the income payable during the time that the employee and his spouse are both alive. The participant must be given a reasonable time before the annuity starting date to elect in writing not to have the retirement benefits provided under a joint and survivor annuity.

¹¹ ERISA § 205, I.R.C. § 401(a)(11), Treas. Reg. 1.401(a)-11, and proposed amendment. The automatic requirement applies only if no election has been made, an event which never occurs in a well-administered plan.

number of monthly payments or dies, with payments to conform to the guaranteed period. In the latter case, the annuity is referred to as a "life annuity with a guaranteed period." The annuitant may elect 60, 120, 180, or 240 months. The rate of the annuity increases with the length of the guaranteed period since life contingencies are not

included in any annuity that guarantees a portion or all of the purchase price. A "cash refund annuity" promises that, if the annuitant dies before the monthly payments equal to the purchase price shall be continued to the annuitant or his estate as has been recovered. If the annuitant dies before the annuity has been recovered, the annuity will be continued to the annuitant's estate (or any other designated beneficiary) for any of the purchase price of the annuity not yet paid. If the annuity payments, it is designated a "cash refund annuity" is that, under the former form, the annuity is refunded in a lump sum at the time of the annuitant's death. In the latter case, the monthly payments of the purchase price has been recovered. The cash refund annuity is somewhat more costly than the straight-life annuity, but it is somewhat less costly than the use of the loss of interest. A cash refund annuity promises to refund only a portion of the annuitant's accumulated employee contributions.

Under a pension plan, the annuitant may elect periodic payments as long as the annuity is in effect. In most combinations of ages, this is the most desirable form. This type of contract is prime to a husband and wife. The annuity may be payable to either one or both of the annuitants, on the theory that the survivor will do the two annuitants. Under the former form, when either annuitant dies, under the latter form, when the retired participant dies first, the annuity continues to the contingent annuitant option."

Under a pension plan.

lower end of the earnings the plan's benefits are not y program. However, there combined plan and Social es substantially exceed their es by as much as 20 or 25 assumed that the employees ey were working and were of living.

ective has been established, action of the income against ways to approach this prob-subsequent chapter, but the automatic adjustment of the nges in the cost of living. y System, the federal Civil Services Retirement System, the states, and some munic-ness firms have been linked e use of the consumer price ection are building up, es- have followed the practice ed employees on an ad hoc, consumer price index as a the full amount of the CPI e uncertainty over the mag-s community generally has ith ad hoc adjustment, rather adjust benefits in conformity Security component of the the CPI provides some pro-orate the problem faced by

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r in establishing a pension ertaking to provide benefits (2) an undertaking to make

contributions on a specified basis. The first approach is referred to as a *defined benefit* plan, and the second is designated a *defined contribution* plan. Under either approach, the employees may contribute toward the cost of the plan.

Defined Benefit Plan. A defined benefit plan² is one in which the benefits are established in advance by a formula, and employer contributions are treated as the variable factor. Plans of this type may be broadly classified as plans where the amount of monthly pension after retirement is fixed, and as plans where the amount varies after retirement. The latter plans are discussed in a subsequent chapter dealing with variable annuities and other devices for protecting pension benefits against loss of purchasing power. This chapter is devoted solely to plans that provide fixed-dollar benefits, which are the dominant type.

A. Benefit Formulas. Benefit formulas of defined benefit plans vary greatly as to details, but on basic characteristics they may be classified into two categories: (1) unit benefit, and (2) flat benefit.

1. Unit Benefit. The distinctive feature of the unit benefit formula is that an explicit unit of benefit is credited for each year of recognized service with the employer. The unit of benefit may be expressed as a percentage of compensation—the usual procedure under a plan for salaried employees—or as a specific dollar amount. When the benefit unit is expressed in terms of compensation, the plan must clearly indicate the items of compensation that will be treated as part of the earnings base. Such items as overtime pay, holiday pay, sick pay, bonuses, and commissions must be specifically excluded or included. If total compensation is not used, and if the definition of pay that is used results in excluding a greater percentage of total compensation for higher-paid employees than for lower-paid employees, the Internal Revenue Service may rule that the plan is not qualified because it discriminates in favor of the highly compensated.

After compensation has been defined, it must be decided whether to credit the benefit earned each year in terms of the compensation for that year or to credit all benefits in terms of the average compensation for a few years close to retirement. When the unit of benefit credited during any particular year of employment is based upon the employee's compensation during that year, the benefit formula is characterized as a *ca-*

²ERISA § 3(35), I.R.C. § 414(j).

the percentage in each salary for the three con-

to encourage early retire-vice, he may reduce the age, such as 30 years, or the plan may place a limit on the amount recognized for benefit for executives who are practicing of providing more benefits known as "front load-

discretion as to the participant's plan, so long as the plan is for a defined contribution group. Concerned lest mandatory vesting standards might be removed that might allow three alternative tests that might be permitted for defined benefit plans.⁵ Since these tests affect the accruals of terminated participants, see the chapter on withdrawal

to provide a floor of protection for the participant that operates independently of the plan. It is common for unit benefit plans to stipulate that the annual benefit is a fixed amount. For example, a plan might stipulate that the benefit payable in monthly installments might stipulate that the benefit not to be less than \$120. This benefit is based on the annual wage or salary for the participant (not less than \$120). There may be a minimum for the total benefit, but the benefit must have a minimum pe-

centage based on career average com-

pensation make provision for a minimum benefit that is expressed as a percentage of final compensation or a percentage of compensation as of some specified date. This type of provision is designed to update the career average salary base to a level that bears a reasonable relationship to the participant's earnings during the years immediately preceding retirement. Whereas the dollar benefit minimum is general and applies to all participants, the percentage of compensation minimum is specific to the individual participant. The latter is generally conditioned on a minimum period of service, such as 20 or 25 years, with reduced minimum benefits being payable for shorter periods of service.

Defined Contribution Plan. A defined contribution plan or individual account plan is a plan that provides an individual account for each participant and bases his benefits solely upon the amount contributed to the participant's account and any expense, investment return, and forfeitures allocated to such participant's account.⁶

A defined contribution plan defines the amount of contribution to be added to each participant's account. Some plans do this directly by defining the amount the employer will contribute on behalf of each employee (e.g., 10 percent of pay). Other plans do not define the amount of contribution to be made, leaving that completely to the employer's discretion; but these plans define how whatever contributions are made will be allocated among the accounts of participants (e.g. in proportion to compensation).

The individual accounts must receive, at least annually, their share of the total investment return, including investment income received and realized and unrealized appreciation of market values.⁷ Some plans allocate investment return quarterly, monthly, or even daily. Most types of assets are subject to fluctuation in market values, although some, such as bank savings accounts and certain annuity contracts, are maintained on a book value basis and, hence, suffer no diminution in value. If market values can decline, individual account balances can decrease as well as increase.

Ordinarily, the total plan assets are completely allocated to individual accounts. The sum of all of the account balances on any valuation date usually equals the total market value of the plan assets. If a participant terminates employment before he is vested, his account balance is for-

⁶ERISA § 3(34), I.R.C. § 414(i).

⁷Rev. Rul. 80-155.

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feited and is applied either to reduce future employer contributions or to increase the accounts of other participants.

When a participant becomes eligible to receive a benefit, his benefit equals the amount that can be provided by his account balance. It may be paid in the form of a lump-sum distribution, a series of installments, or an annuity for the lifetime of the participant or the joint lifetimes of the participant and his beneficiary.

The principal types of defined contribution plans are generally classified as follows:

- A. Qualified plans under Code Section 401(a).
 - 1. Money purchase pension plans.
 - a. Traditional money purchase plans.
 - b. Target benefit plans.
 - c. Thrift plans (other than profit sharing plans).
 - 2. Profit sharing plans.
 - a. Traditional plans.
 - b. Thrift plans.
 - c. Cash or deferred arrangements.
 - 3. Stock bonus plans.
 - a. Traditional plans.
 - b. Employee stock ownership plans.
 - 4. Voluntary employee contributions under qualified plans.
- B. Tax-deferred annuities under Code Section 403(b).
- C. Deferred compensation plans for state and local governments under Code Section 457.
- D. Individual retirement savings (including simplified employee plans) under Code Sections 408 and 409.
 - 1. Individual retirement accounts (IRAs).
 - 2. Individual retirement annuities (IRAs).
 - 3. Individual retirement bonds.
- E. Nonqualified plans.

Plans of these many types are frequently established with two objectives: provision of retirement income and deferral of current taxable income. Sometimes one is the primary objective and sometimes the other is. Traditional money purchase plans and target benefit plans are frequently designed with a primary objective of providing retirement income, and they are discussed in the remainder of this chapter. The other types of plans, while often established to meet retirement income needs, are more frequently adopted primarily to defer taxable income: these types are discussed in later chapters.

less, the highest percentage at which contributions are made for any key employee.

A top-heavy plan may not take account of compensation in excess of \$200,000 in determining benefits or contributions.³² This \$200,000 will be subject to cost-of-living adjustments after 1985 in the same manner as the dollar limits under Section 415.

Under top-heavy plans, if there is both a defined benefit plan and a defined contribution plan, the 125 percent limit for the dollar limit on contributions and benefits under the combined plans is reduced to 100 percent.³³ However, this reduction does not apply to top-heavy plans where the value of accrued benefits for key employees does not exceed 90 percent of such value for all employees and where certain additional benefits or contributions are provided for non-key employees.

Advantages and Disadvantages of Plan Approaches

Each of the various types of plans described in this chapter has advantages and disadvantages.

Defined Contribution Plans
 — The basic appeal of the traditional money purchase approach is its simplicity. It is easy for the employees to understand and for the employer to administer. It is essentially an arrangement under which funds can be accumulated on behalf of active employees, without actuarial complexities, and used to provide retirement benefits within a wide range of ages, as permitted by the plan. There is no need to designate a normal retirement age, the significance of which is discussed later.

Under money purchase and target benefit plans, the accumulation of contributions in the participant's own individual account has strong psychological appeal and reinforces his feeling of security. Sums in an individual account, whether fully vested or not, have more reality to the participant than the accrual of pension credits toward a distant and uncertain retirement.

Defined contribution plans (both traditional money purchase plans and target benefit plans) do not ordinarily require actuarial computations. This creates an expense saving, compared to defined benefit plans. When a defined contribution plan provides benefits in the form of an annuity payable for life, an annuity is usually purchased from a life insurance company, which performs the needed actuarial functions. A minority of

³²I.R.C. §416(d).

³³I.R.C. §416(h).

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defined contribution plans provide for payment of life annuities directly without the purchase of an annuity contract; in these cases, actuarial calculations are required.

Another advantage of defined contribution plans from the standpoint of the employer is that his pension cost for all service rendered to date is fully funded. Unlike defined benefit plans, a defined contribution plan has no unfunded liability. A closely related advantage is that the defined contribution plan is not subject to plan benefits insurance (discussed later). The employer pays no premiums to the Pension Benefit Guaranty Corporation (PBGC) and is not exposed to a contingent liability if the plan should terminate. From the employee's viewpoint, there are no unfunded accrued benefits to be lost if the plan terminates.

A traditional money purchase plan has the further advantage that the future cost is fixed as a percentage of pay, subject only to reductions for forfeitures. Target benefit plans have higher costs for older participants, which may cause the cost of the plan to increase as a percentage of total pay as older employees receive pay increases and related increases in the target benefit to be funded. Future costs for a defined benefit plan are even less predictable, since the employer's costs will depend upon future investment experience and other factors, and may differ markedly from the actuary's initial estimate.

Defined benefit plans are more flexible

Defined benefit plans offer more flexibility in meeting costs than a money purchase plan or target benefit plan. In a money purchase plan or a target benefit plan, each year the employer must contribute the exact amount required to be credited to employee accounts, less any forfeitures. In a defined benefit plan, the existence of an unfunded liability creates flexibility in funding, depending upon the rate at which the employer chooses to fund the unfunded liability. The employer who has been funding the unfunded liability more rapidly than required has a credit balance³⁴ that can be used to reduce or entirely eliminate the required contribution for a particular year.

Defined benefit plans and target benefit plans can provide benefits for years of past service before the plan was established. A traditional money purchase plan cannot. For this reason some employers have established defined contribution plans for future service and defined benefit plans for past service benefits.

The Internal Revenue Service requires that all qualified pension plans (defined benefit, money purchase, and target benefit) make benefits

³⁴Funding requirements are described in Chapter 17.

available in the form of an annuity, either an annuity payable for life or an annuity for a period of years.¹⁵ A plan may also provide a benefit in the form of a lump sum, but no plan is required to do so. In practice, the availability of lump sums is less common among defined benefit plans than among money purchase plans. But where lump sums are available, the defined contribution plan in effect encourages the retiring participant to take his account balance in a lump sum rather than in the form of a life income. The periodic reporting to the participant of his account balance increases his awareness of the monies in the account and seems to dispose him to cash out the balance at retirement.

When a life annuity is to be provided under a defined contribution plan, usually an annuity contract is purchased from a life insurance company. This is the only practical approach for a small plan. The cost to purchase an annuity under an individual annuity contract, and under most group annuity contracts, is higher for females than for males, recognizing the longer average life expectancy of females. Under these contracts, for any given dollar accumulation at retirement, the monthly benefit for a female employee will be smaller than that of a male employee. The actuarial value of the male and female benefits will be the same at the point of retirement; but the monthly benefits will be different, except under certain 100 percent joint and survivor annuities. Female employees have objected to a differentiation in annuity purchase rates based on sex and have demanded that the annuity benefits be determined on the basis of an annuity table that combines male and female mortality; a so-called unisex table. There have been numerous recent court cases dealing with the question of whether such differing benefits violate Title VII of the Civil Rights Act of 1964. The Supreme Court is expected to resolve the question. Under a defined benefit plan, male and female employees accrue pension benefits on the same basis, and the employer absorbs any cost differences between the sexes; an exception in many plans applies to optional forms of annuity. In target benefit plans, it must be decided whether the factors used to determine contributions are unisex or sex-different factors; sex-different factors may be determined to violate Title VII.

Assuming
Under a defined benefit plan the investment risk is borne by the employer, while under a defined contribution plan the investment risk is borne by participants. If investment experience is favorable, it is clearly an advantage to the party that enjoys it, and may be considered a dis-

¹⁵Treas. Reg. 1.401-1(b)(1)(i).

an annuity payable for life or may also provide a benefit in required to do so. In practice, common among defined benefit

But where lump sums are effect encourages the retiring lump sum rather than in the ing to the participant of his f the monies in the account alance at retirement.

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advantage by the party that does not share it. If investment experience is unfavorable, exactly the opposite is true. Under defined contribution plans, there may be participant dissatisfaction with the plan if the investment results are poor.

Many defined benefit plans provide annual benefit statements to all employees showing the amount of retirement income payable at normal retirement age, both the accrued benefit based upon service to date and the projected benefit based upon projected service. The defined contribution approach does not lend itself to simple calculation or expression of benefits. The benefits will be whatever the accumulated account balance will provide. Benefit projections are sometimes prepared, but they generally rest on the assumption that current compensation and some assumed rate of investment earnings will prevail to a specified retirement age, with no change in annuity purchase rates or the corresponding actuarial assumptions of a trust fund plan. It should be noted, however, that uncertainty also surrounds the projection of benefits under a defined benefit plan because of the unpredictability of future salaries. - 14 12 1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25 26 27 28 29 30 31 32 33 34 35 36 37 38 39 40 41 42 43 44 45 46 47 48 49 50 51 52 53 54 55 56 57 58 59 60 61 62 63 64 65 66 67 68 69 70 71 72 73 74 75 76 77 78 79 80 81 82 83 84 85 86 87 88 89 90 91 92 93 94 95 96 97 98 99 100 101 102 103 104 105 106 107 108 109 110 111 112 113 114 115 116 117 118 119 120 121 122 123 124 125 126 127 128 129 130 131 132 133 134 135 136 137 138 139 140 141 142 143 144 145 146 147 148 149 150 151 152 153 154 155 156 157 158 159 160 161 162 163 164 165 166 167 168 169 170 171 172 173 174 175 176 177 178 179 180 181 182 183 184 185 186 187 188 189 190 191 192 193 194 195 196 197 198 199 200

This greater unpredictability of benefits under defined contribution plans is not only a problem of communication through benefit statements; it is also a problem of achieving benefit objectives. A defined benefit plan with a final average pay formula can come close to meeting objectives for retirement income amounts; but a defined contribution plan—even a target benefit plan—may miss its mark. A defined contribution plan may prove more effective for younger workers than for older workers, or vice versa.

The negotiated contribution plan under collective bargaining has some characteristics of a defined benefit plan and some characteristics of a defined contribution plan. It shares some of the advantages and disadvantages of each type.

This discussion of advantages and disadvantages has been limited to defined benefit plans, traditional money purchase pension plans, and target benefit plans. Other types of plans that may be used to meet retirement needs, such as profit sharing plans, will be considered in later chapters.

Questions

1. What is the basis for the statement that a total retirement income of 60 to 75 percent of an individual's gross earnings at time of retirement will

making a lump-sum cash distribution.²⁰ This privilege is granted to the employer to avoid the expense of keeping track of a relatively insignificant deferred claim against the plan.

Statutory Vesting Requirements

Before enactment of ERISA, employers were under no legal obligation to provide for vesting of employer-financed benefits prior to retirement, except for unusual circumstances. The law did provide that all accrued benefits of a participant had to vest, to the extent funded, in the event that the plan terminated or the employer permanently discontinued contributions to the plan. In addition to these rules that applied to all plans, the Internal Revenue Service could require any plan to provide for reasonable preretirement vesting if it appeared from the facts of the case that the plan would otherwise discriminate against the rank-and-file employees in favor of the prohibited group (officers, shareholders, supervisors, and highly paid employees). In certain situations, usually involving small plans, the officers and other favored employees would be expected to remain with the firm until normal retirement, while the rank-and-file employees would tend to terminate their employment and fail to qualify for benefits. Vesting provisions keyed to the expected termination pattern could ensure that the plan would operate for the benefit of the employee group in general, rather than just for the proscribed group. Finally, full and immediate vesting has been mandated for plans established and maintained by self-employed persons since they were first authorized in 1962 (but will no longer be required after 1983).

The minimum vesting standards established by ERISA were premised on the grounds that vesting of accrued benefits after a reasonably short period of service is necessary (1) to assure equitable treatment of all participants; (2) to remove artificial barriers to changes of employment, hence enhancing the mobility of labor; and (3) to assure that private pension plans fulfill their social role of supplementing for a broad segment of the labor force the old-age insurance benefits provided under the Social Security System.²¹

²⁰ERISA § 204(d), (e), I.R.C. § 411(a)(7).

²¹See Dan M. McGill, *Preservation of Pension Benefit Rights* (Homewood, Ill.: Richard D. Irwin, 1972), chap. 2, for a discussion of the public policy considerations involved in the vesting issue. Chapter 5 of that volume provides a detailed analysis of the factors affecting the cost of vesting and the various ways in which the cost of vesting may be measured and expressed.

ERISA
only applies to employee plans
however it may provide
additional and otherwise
relevant information

SENATE JUDICIARY COMMITTEE MEETING

CSSB56 (State Affairs) "An Act amending the longevity bonus program and the permanent fund dividend program, establishing an annuity program; and providing for an effective date."

February 27, 1985

Meeting called to order by Senator Rodey.

Attendance at meeting: Senator Faiks, Senator Kelly, Senator Ziegler. Senator Rodey, Chair.

Senator Rodey: Today what I'd like to do is take a look at the annuity aspect of the longevity bonus bill. There's been a great deal of talk about the annuity aspect, and today I'd like to spend some time in detail going into the proposal in the bill, taking a look for sake of comparison at what the private market does. We know that works efficiently and effectively. Compare it with the provisions in the bill, and then make any decisions that we might want to regarding possible changes if we think they're appropriate. What I'd like to do first is to call Mr. Steve Woodruff to testify. Mr. Woodruff is a professional who markets equities and has considerable experience. Mr. Woodruff, would you please join us at the table? Steve, could you state your name for the record, and give us a little background on who you work for and exactly what your relationship has been with annuities.

Steve Woodruff: I'm Steve Woodruff, I live here in Juneau. I've been here about 10 or 11 years. I work primarily in the field of annuities, both tax-sheltered and deferred annuities. I work with Equitable Life Assurance Society of the United States primarily. They are the largest pension fund manager in the United States. I work with some other companies on occasion also. Annuities comprise about 90% of my work.

Senator Rodey: Could you give the committee a step-by-step outline of what you do to market an annuity?

Steve Woodruff: I'm sure marketing techniques are different for different professionals, but primarily it occurs in three stages; a solicitation, or acquisition of some form of mailing list, which I use predominantly. Putting that into my computer system, and then preparing sales material to be sent to solicit responses regarding annuities to prospective people on the list. This usually requires some initial information be sent with my letter. I normally get back. After the responses come, I contact the

individuals and usually set up an interview at that point, which is probably the most time-consuming element. Marketing annuities - there are so many different types, and so many ways of structuring an annuity, depending upon individual need, that I normally need thirty minutes to an hour with a client to ascertain the individual circumstances of the client, and their needs, and develop a proposed annuity to fit that need. Following that, if I do place the annuity, there is, of course, service work involved following that time. That's primarily how I market my annuities. Start to finish, probably be per client two and one-half hours work.

Senator Rodey: When you talk with someone about annuities, what factors do you look at as you make a decision on which annuity would be appropriate for an individual?

Steve Woodruff: The factors that I look at are quite diverse. I look at their income level, I look at - well, the primary thing is what do they want to do, what are they trying to accomplish with the annuity? Then I couple that with their income level, their ability to take risk, what other assets they have, how much are they at risk in other assets, what types of assets do they hold, how liquid are they, how non-liquid are they, what type of benefits they're trying structure, say, at retirement. The annuity has to be thoroughly qualified on those bases. In an annuity you generally are looking at long-term goals, as opposed to short-term goals. Annuities are not appropriate for a short-term investment situation, generally. Short-term, two to three years. Annuities are more appropriate for ten, fifteen, twenty, thirty year or forty year periods, things of that nature. That is probably the most time-consuming element of my work with a client - trying to ascertain the exact need and fit the type of annuity to his specific individual need, which is going to vary from client to client.

Senator Rodey: You mentioned time - what is the minimum amount of time...as we look at the bill we're going to have to tell people about annuities and what they are. What is the minimum amount of time that would be necessary to transmit a reasonable amount of information about an annuity?

Steve Woodruff: That again, varies quite a bit. If the person who sits before me is fairly knowledgeable in financial matters, I can do it in a matter of ten minutes. If they are not, it may take thirty minutes

just to educate them on the annuity itself.

Senator Rodey: Have you taken a look at the annuity proposal that is embodied in SB56, that this committee is hearing now?

Steve Woodruff: Yes, I have.

Senator Rodey: Could you market this kind of an annuity as it's written in the bill?

Steve Woodruff: No.

Senator Rodey: Could you tell me why.

Steve Woodruff: Three basic reasons, and they're all problems in the bill. Let me pull my copy of the bill here, I underlined the problems I had. First, and most striking, on the first page it says in lines 22, 23, 24 and 25, "by authorizing general fund supplements that would result in annuity payments that are larger than an individual could earn through private investment of the permanent fund dividend." That is an extremely broad statement. That is, in effect, saying, "I can guarantee everything under the sun to beat anything you can do in the private sector." Now, if I could actually say that statement, which I can't in my profession - I would be subject to loss of license and suit, among other things - if I could say that statement, in good conscience, that I can beat anything you can possibly do with this money outside of this program, I could market it. But I can't say that statement.

Second thing is, and this comes down to more critical elements of the bill, the survivor benefit element, which says once you start receiving an annuity, after age 65, if you die the payments stop and do not continue to a beneficiary or anybody else - they revert back to the fund. All annuities in the private sector offer some form of survivor rights in an annuity. Granted, there is a straight-life annuity. The person who has no heirs, no survivors, no children, no wife - a straight-life annuity can be applicable. But that's not too many of us. And on that basis, that is something that can be picked up in the private sector in a very diverse fashion. Survivor benefits in annuities - I can build almost anything to suit a client - whatever he wants to do in a survivor situation.

The third element that is extremely critical; as I read this bill I don't see any comments with regards to the tax status of the money. Meaning, when the

money goes in, or when it comes out.

Senator Rodey: How important is the tax status to an annuity when you compare a state annuity with the private sector, and we will effectively be competing because people will have the opportunity to keep it in the state annuity or take it as a dividend and put it into a private program.

Steve Woodruff: It's of paramount importance. The reason being, anytime you can invest with before-tax dollars as opposed to after-tax dollars, it makes all the world of difference at retirement or when you pull that money out. If a person's in a 30% tax bracket, and they invest \$100, it's going to cost them, in spendable income, \$70. So they got a \$100 investment, but it only cost them \$70. They've made close to 50% up-front, just on tax leverage in that investment. Without that, the effects are dramatic, investing with after-tax dollars. A person could take the permanent fund, as it sits now, take their yearly dividend, put it into an IRA, and have everything that I've mentioned up to now, and eliminate the problems that are in this bill. They could have survivorship benefits, whenever they go to an annuity, they could have the tax benefits, we don't promise them absolute unequivocal rates of return that could beat anybody. We can't do that, but they can solve the tax problem, they can solve the survivor benefit problems. They can also retire at a time of their choosing, with an IRA after 59}. Here it's tied into age 65. With an IRA they have the opportunity to do it between 59} and 70}. They have a great deal of flexibility. Too many things are too straight-laced - it's inflexible. And, I couldn't tell a client in good conscience, or in good ethics, to put his money here. And I wouldn't, the way it sits now.

Senator Rodey: We've talked about the rate of participation - we've been estimating the rate of participation. You have a great deal of experience - certainly more than anyone else in town in the annuity field. It's been estimated that 30% of Alaskans would participate in the annuity program. Is that a reasonable estimate, the way the bill is written now, given the comments that you've made?

Steve Woodruff: No, I think maybe 5% might fall for it, at best. A little background about my rates of success in marketing my product - Equitable, among others, has some of the very finest annuity products we have in this nation, interest rate-wise, everything - investment-wise, all things considered. If I mail out a hundred letters to a qualified list of people

I know that probably have need of this product - we've pre-qualified them, I'm not shotgunning - I will get back about 4%. 4% of those people will write back to me and say, yes, I want more information. I will sell about 95% of the ones that send a letter back on the annuity. Now that's doing it with one of the very best and most competitive products anywhere to be had in the nation. And, to suppose that you would better that with this product, with all of its inflexibilities and drawbacks, would be very presumptuous, I think. If you got 1% I think you might be lucky.

Senator Rodey: Do you have any suggestions - you mentioned some of the difficulties from a private sector point of view. Do you have any suggestions as to how we might cure these. Obviously, the statement of guarantee could be eliminated. How should be structure survivor benefits after the age of 65?

Steve Woodruff: If you're going to maintain age 65, I think you should have elements in there which would provide rights of survivorship to either a spouse on a limited basis. As an example, you can have an annuity which says we're going to pay for the lifetime of annuitant. If he dies, we will pay half those benefits for the lifetime of his beneficiary. That's a joint survivor annuity - 50% survivor. It could be joint two-thirds. It could have some form of survivorship option to allow those proceeds to continue to at least one beneficiary after the annuitants death. I would think, and I realize the structuring problems - the age 65 is important to this bill - to make it more compatible with things that can be done in the private sector it should be moved back to age 60 to compare more favorably with IRAs, but I realize that it could be a problem.

Senator Rodey: From a private market point of view, and obviously the more people that participate in a plan the sounder the plan would be - the law of large numbers - when you have a plan like this. In your opinion if we move back to 59} we would be far more competitive than we are at 65, is that correct?

Steve Woodruff: Right, right.

Senator Rodey: How much of a competitive edge do we lose once we go to 65 - what does 5} years cost us?

Steve Woodruff: I don't think that's going to cost a whole lot. However, because IRAs are so common, and they're structured around age 59}, I think you'll find more and more people planning their retirement around

that age period. To know that they can't receive these benefits until 65 will change their planning. It means they're going to have to delay income sources five years later into retirement, for money that they're counting on in retirement. I can't say exactly how much competitive edge you'd lose there, but that's not nearly as critical as the survivor benefits.

Senator Rodey: The survivorship is absolutely critical?

Steve Woodruff: Absolutely.

Senator Rodey: Could you market something without a survivorship benefit to it?

Steve Woodruff: Probably not.

Senator Rodey: I don't know for sure, but I presume that at least the draft language was patterned on retirement fund actuarial figures which accounts for a natural attrition of people in the group which, again, bolsters the retirement feature. Do you have any plans like this that you operate that would in any way be similar to the plan embodied in the bill?

Steve Woodruff: No.

Senator Rodey: Nothing with that kind of lack of survivorship?

Steve Woodruff: There is nothing in the private sector that's like this. It's not marketable. There's no pension plan, there's nothing like this, that's structured this way. You take a look at this bill as a whole - if I have a choice between investing my money before tax dollars, and know that my survivor can get my money when I retire, that I have options of earlier retirement, I have options of many ways I can take the money at retirement, and compare it with this where I have simply no options at retirement, supposedly no tax benefit during accumulation periods, there's no way this could be marketed - I couldn't do it.

Senator Rodey: If survivorship is critical, back to tax status for a second. This has talked about and without anything conclusive with regard to guaranteeing the tax status. Is it absolutely necessary to have the fund tax-exempt?

Steve Woodruff: If you're going to compete with the private sector, yes.

Senator Rodey: That is the thrust of my question. Are

all of yours tax-exempt, IRS-approved plans?

Steve Woodruff: Yes. Now, I do have plans that are deferred annuities where the principal going in is not tax-sheltered, but the interest is. But the only time I use those plans is when a client has done everything he can in the tax-sheltered area. And then if he needs to do additional things investment-wise, and get tax breaks, he can go to what is called a deferred annuity, where the money goes in, has already been taxed, but the interest remains tax-deferred. But again, I don't recommend that to a client until he's done the other things first.

Senator Rodey: I presume then you're talking about relatively wealthy clients who have done a number of tax savings plans - whatever might be appropriate in their situation.

Steve Woodruff: Yes.

Senator Rodey: Then to recap what you've said, that the tax status and the survivorship are important, are vitally important, and unless we pay attention to those two, we will be at a significant competitive disadvantage with regard to the annuity.

Steve Woodruff: That's putting it mildly. I think it would be critical - they talk about giving the money in their interest rates during the accumulation period - whatever that is, it's going to have to be competitive with the general marketplace. I do think that's possible, but they're going to have to stay competitive. Now, I'm not at all times right at the top of the marketplace, but I'm still successful. I'm usually within 3% of the top of the marketplace, and if they come out and offer 7% in today's market, that could be a big drawback, just as a comparative example. I have one other thing here, well, I've already touched on it briefly. As the bill stands now, it's required that person start receiving annuity benefits at age 65. I think they need an option to defer that date. Now, this does not hit a large group of people. But, I do have clients who are over 65 who at this point make a lot of money each year and are trying to defer income each year, still, after age 65. They don't want it and don't need it, for whatever reason. I have people over 70 doing that. Now, granted, that's not a large group of people, but that flexibility could be important. Particularly for people here in Alaska. There are several tax-deferral mechanisms available in Alaska for people on our salary levels. And, quite often they are not going to want to take all these

deferred plans at retirement. They're going to want to spread them out a little bit. If they're all bunched up, that can create a tax hazard as bad as before. So, I think that's flexibility that needs to be looked at. Those are pretty much the shortcomings I see in the plan itself.

Senator Rodey: I very much appreciate your comments, and your very succinct testimony. Senator Ziegler, do you have any questions with regard to the testimony that Mr. Woodruff's given?

Senator Ziegler: Yes, I can make a comment. It's nice to hear there is another side to this proposal - that there are pitfalls, perhaps.

Senator Rodey: That I view as the committee's job to find those things in the bill which may be potential problems, and correct those problems or at least note those problems as the bill goes along. The bill, after it leaves this committee, will have a series of steps that it goes through, and this is certainly not the final one. It's important to have the information with the bill in regards to what changes are made in it, because it will affect a great many older Alaskans. Thank you Mr. Woodruff. I appreciate your being here - it's great to have an expert in the field to tell us a little about annuities. Let me have Debra Vogt join us.

Debra Vogt: Thank you, Senator Rodey. My name is Debra Vogt, I'm Assistant Attorney General with the state, and I have worked with the Special Committee on Longevity Bonus from the inception of that committee, and have followed SB56 as it has wended its way through the Senate. I didn't prepare any specific remarks, but I would have some comments in response to Mr. Woodruff's comments if you'd like to hear them.

Senator Rodey: I certainly would.

Debra Vogt: In the first comment that he had about the - I unfortunately just have SB56, not the committee substitute, but I don't think this has changed. On the first page where it says, "authorizing general fund supplements that would result in annuity payments that are larger than an individual could earn through private investment." What that language is the front-loading - the authorization for front-loading which I don't believe Mr. Woodruff would disagree would substantially enhance the value of a state run annuity program over a private annuity program with no additional kicker thrown in. You

see what I'm saying? If there is a significant amount of front-loading, then my giving up a \$400 check, if it's matched by \$800 from the state, is going to result in a much larger annuity to me than even an IRA, or certainly a private sector annuity would give me.

Senator Rodey: Does this raise two questions: 1) a requirement that there be front-loading, and I think we should know that. I have no opinion one way or the other - that's a financial question that the committee will not deal with.

Debra Vogt: It's permissible in the bill, but that's just what the language there on page one is referring to.

Senator Rodey: The second thing is, does that language provide any liability for the state? Does it require front-loading, and does it make the state liable if there is no performance equal with the guarantee?

Debra Vogt: No, I think that simply this is language in the plannings and purpose section. And the language there is simply - - it's the purpose of this legislation to create an annuity program and to encourage Alaskan's to participate by authorizing general fund supplements so that the bill authorizes the front-loading, but it certainly doesn't require it. As a lawyer, I'd say there's no recourse that a person would have if the legislature chose in one year not to front-load - in terms of any kind of guaranteed interest rate, or guaranteed earnings off of the fund.

Senator Rodey: There's always been some question as to the efficacy of language like this - purpose language in a bill. An attorney once called it a "chicken soup clause" in that it was much like chicken soup for a cold - it wouldn't do you a great deal of good, but it wouldn't do you a great deal of harm, either.

Debra Vogt: The second point that Mr. Woodruff raised was that the bill does not provide for choice of benefits after age 65. The State Affairs Committee did amend the bill to provide survivor benefits should a person not reach 65. But after 65 the bill provides for a straight-life annuity with none of the other choices that are often available in private plans or within the state deferred comp, for example. And I might just kind of reiterate some of the things that the Longevity Bonus Committee considered in choosing what it did in what's turned into SB56. One of the things that the committee looked at was the fact that longevity bonus program now pays living, surviving elderly Alaskans, and that a survivor option isn't

necessarily consistent with the plans that this program is intended to replace. Another consideration of the committee was that many retirement plans offer joint and survivor options or many private annuities often because there's one annuitant in a family unit, and there's often a dependent spouse, particularly in a wage-earning situation. But since the longevity bonus replacement annuities would be available to every Alaskan, so that they would most likely be available to both spouses, the committee felt that the rationale for a lot of the - - for instance the amendments to ERISA this year making it mandatory that you at least get the permission of the spouse if you don't choose survivor benefits. But that generally comes from a perception that there's often a dependent spouse that doesn't have his or her own annuity, that is depending on the other spouses's annuity. So that consideration not being present here, the committee in large part opted for the simplicity of a single straight-life annuity available to each annuitant. I might also add that the choice of benefits is an option that the Senate or any other body of the legislature might choose to put in the bill and it would not do any violence to the overall workings of the bill. I think there's some confusion, from some of the public testimony that I've heard, that it's necessary to have a single option of a straight-life annuity in order to make the payments that are envisioned under this bill. In other words, the perception that you can't give survivor benefits because you have to be able to pay the straight-life annuities under the - - you need to take the money from one participant in order to pay the other. And that's just simply not true. The bill could allow the flexibility of any variety of benefit options, survivor benefits, or some annuities pay, like, for 15 years certain and then nothing in the 16th year. You could add those to this bill without substantially altering anything else in the bill. It just means that a member of a family of two would get a smaller annuity if the survivor benefits were chosen than they would if they didn't choose them.

Senator Rodey: Were the various approaches, accompanied by running numbers out based on actuarial tables?

Debra Vogt: No, I don't think - I don't recall that anybody ever ran any numbers on joint and survivor options, for example. I would guess that probably what would happen is that the maximum possible annuity would still be the straight-life option. If you chose a payment option that paid you less, then it might mean that you wouldn't meet the target amount, but it wouldn't effect the program

for anyone else.

Senator Rodey: Would it be possible to run figures to show what the funding requirements would be between a survivorship option and a ...

Debra Vogt: Well, the funding requirements wouldn't change at all that I can see. I may be wrong - missing something, but so long as you set the - the funding requirements are all on the ALB side and they are a function of the annuity only to the extent that the annuity payment that's available to a 65-year-old in a particular year sets the ALB payment that is made. And if you leave the calculation of the remainder ALB based the way it is in this bill, in the straight-life annuity, even though you offered other options that would effect an individual's total assets, but it wouldn't effect the financial commitments of the legislature to the bill at all. I guess another thing that I hear a lot of comments about is whether the program is actuarially sound, and whether it will work. And I guess I sense some confusion on a lot of members of the public, at least, about what participation rate do you need in order to make the program work. And, I guess, from the way I understand the workings of the bill, if only one person participates, the program works practically in the sense that you have an annuity account that's growing, and as a result of ALB payment that is declining and the overall practical mathematics of the bill work the same whether one person participates or 500,000 people participate. The other half of the question is whether the program socially works, and that's certainly a policy question that's beyond my expertise, but I would think would depend on participation rates. I wouldn't think that a legislature would think a program that one person participated in was a program that was working. Making myself clear - the practical functioning of the bill is not a function of the rates of participation, it works if only one person participates, just as Mr. Woodruff can sell one person one single annuity that works and is actuarially sound, because he places it with an insurance company that takes the actuarial risk. That's it. Am I making myself clear?

Senator Rodey: I think perhaps I'm only following you part of the way, but let me ask another question. Mr. Woodruff gave a private market viewpoint. To what extent did the committee take a look at what happens in the private market when it looked at possible participation rates, for example. And then the box-checking and things like that.

Debra Vogt: The committee, as I think I testified last week, hired the actuarial firm of Johnson and Higgins in Seattle, specifically Mr. Pete Hutzel with that firm, and one of the questions that we asked Johnson and Higgins to look at was participation rates. And I think - well, I've got a copy of Pete Hutzel's response - and it basically is, "gee, there's a wide range of potential participation, and there's no clear precedent for this kind of a program, because we just don't have states offering annuity programs to the entire population." What he used as a point of reference, and this is very different from what Mr. Woodruff was talking about, he used employer-employee participation plans as a point of reference. And I have a sheet here in front of me has three plans that he analyzed that two of which had easier access than the plan embodied in SB56. In other words, some of the points Mr. Woodruff was making, that you had more access to the flexibility to the use of the funds during the life of the program than you would under SB56, and one of them had the equivalent of some front-loading, the other one did not. That would mean some employer match into the annuity account. And with the match, he informed the committee that in that kind of program a 50%-60% participation rate could be expected. With no employer match, or the equivalent of front-loading, he put out the figures of 20%-40%. He then compared with some pension plans that were no more accessible than would be your deferrals under this plan, but which also had some front-loading or its equivalent and the participation was 60%-80%, and his bottom line was its impossible to predict what the participation would be, and that a range of between 20% and 80% had ought to be investigated. He also told the committee that a key factor in the participation would be the education of the public, and recommended that a fairly substantial program to get the word out to the public. But I think it's important to point that what Mr. Woodruff is talking about here are private, personal, individual annuities. And it might be interesting to hear from Mr. Humphreys from the state as an employer - participation in deferred comp and the retirement programs that the state offers. This is kind of someplace in the middle. It's not a one-to-one, I go to Prudential and buy an annuity program, nor is it an employer-employee relationship. It's probably the biggest open question under the bill as what would be the participation rate.

Senator Rodey: The tax status we've discussed. Can you sum that up for the committee in twenty-five words or less?

Debra Vogt: I think you've seen the committee report that the tax counsel that the committee hired basically opines that with a fair amount of front-loading, or a substantial amount of front-loading, tax-deferability was quite certain and that with no front-loading at all tax-deferability was very uncertain, more likely that you would be taxed in the current year. I think the committee was aware that to the extent that an individual had the option of participating in this program, or participating in an IRA, which is definitely tax-deferable, that those wealthier individuals who are concerned about the tax consequences would naturally prefer the IRA if there were no front-loading under this bill. I think the committee also recognized that many individuals have simply "maxed out" on their IRA capabilities and then are looking at placing after-tax money with a private carrier in an annuity and this program, is certainly even without front-loading at least as or more attractive than that kind of an option. Again, similar to the programs Mr. Woodruff was discussing, even if you were taxed on your contributions, you would not be taxed on your interest as it accumulated over the years until you actually began receiving payments. So I guess there's a question of whether the buy-in itself is taxable, certainly any front-loading that the legislature chose to add to the program would not be taxable and the interest that accumulated would not be taxable. All of it's taxable when it comes out the other end.

Senator Rodey: As all are. Senator Ziegler, do you have any questions of Debra Vogt?

Senator Ziegler: No.

Senator Rodey: Thank you very much. Paula (Scavera) do you have any additional comments to add? (Answer indiscernible.) Mr. Humphreys would you care to make any comments with regard to the testimony that we've heard today, having considerable experience in the public sector annuity?

Ken Humphreys: Yes, thank you Mr. Chairman, just very briefly. It did some guts to accept your invitation today, but I have no prepared statement Mr. Chairman, thank you. Just a couple of very brief comments. As I indicated in the letter that I wrote on February 1, I think I would agree with what Ms. Vogt was saying about survivor benefits. It's been sort of a mystery to me why they would want to limit this option insofar as the person who elected the option - a joint survivor benefit - is the one that's paying for it. I'm not sure what purpose it serves. There's as far as I can

see a misconception going that to allow someone to designate his or her spouse as beneficiary would somehow take money away from the younger participants in the program. I don't understand at all how that would work insofar as the annuity amount is based on the participant's account value in any event. And whatever reduction for the option the person took would come out of his payments, and it would be up to that person.

Senator Rodey: In your experience, how important is the survivorship option? You deal with many thousands of state employees who - they are a small public compared with the larger Alaska public, but probably reflective of public sentiment in general - how important is that?

Ken Humphreys: Well, I can't quote you a percentage of people who elect it without doing a little bit of research, but it's like a lot of other things. It's awfully important to the people who want it. People who want a survivor option tend to want it very badly indeed.

Senator Rodey: Is that a few people, or a significant amount?

Ken Humphreys: It's definitely a significant amount. (Indiscernible conversation with member of audience).. .. 40% in the retirement programs where you do not have a lump sum option. A lump sum option I do not believe would be permissible in this program, without totally forgoing the tax status. In other programs such as deferred comp and supplemental benefits system where a lump sum option is available, it tends to be very popular. But yes, of those who take a strict annuity over time, it's a very definite, significant percentage. And I think, there's been a lot of concern about participation rates in this program. From a technical point of view, I don't think any particular participation rate is required. It's not necessary for Revenue to be able to invest the funds, presumably they would be invested in the same way as, and along with, public employees' retirement funds. So volume is not really required in that respect. You get some economies of scale in the administration and such like, with more participation, but it's not required. But clearly, putting an option like that in would enhance it. A person, knowing when they got to be age 64, if they had a terminal illness that they were in essence going to draw a couple of months of benefit and lose whatever they put in it over the past twenty years or so, I think is a consideration. I think obviously, as it's been pointed out, the tax status is a

consideration. It's an important consideration. I'm not suggesting that the program would be failure without that, but certainly participation would be lower. The only other comment I would make, Mr. Chairman, is just the one again that I pointed out in my February 1 letter, that a lot of the complication of the program obtains, I think, from the continued participation after age 65 instead of fixing the benefit. That's a policy decision - it's not unworkable that way it just adds a good deal of complication. I'd be happy to respond to any questions.

Senator Rodey: What participation do you have in, for example, the SBS program which is desirable but less than uniformly selected.

Ken Humphreys: Well it's 100%, virtually because it's mandatory. And the same is true with the public employees' system. There are very few exceptions. A few temporary employees are not covered, so it's impossible to say because those are mandatory. As far as deferred compensation, which is probably the closest that we have to it, in the sense that it is voluntary, it is a tax-sheltered program, and there is a lot of flexibility about how you can get the money back afterwards. I think the participation in that program probably runs between 15%-20%. Just for a guess, say 20% of state employees. Of course, there is no front-loading, but again the options, that is how you may use the funds, and at what time you can take the funds, it's completely open. Any age virtually, as long as you've terminated your employment, any form of payment, and tax-deferral is assured there. So the only disadvantage that I can see that that program would suffer for a state employee versus this is the prospect of front-loading. And I guess a prospective participant could assign his own probability to that. You know, betting with the other people about what the legislature is going to do.

Senator Rodey: That's always a hazardous course of action. Do you have any figures or any guesses in the absence of figures as to what, given a 20% rate for deferred compensation what the attractiveness of the private market is to state employees for IRAs, Keoghs, similar private plans.

Ken Humphreys: Mr. Chairman, I have no statistics, or really any way to get any that I'm aware of. The only information that I have is just as a private

individual just from what I hear of friends of mine. I hear of people buying them around tax time when they find out they're going to owe the government \$2,000, and some people will buy an IRA instead. But I have no idea how prevalent that is.

Senator Rodey: I have no further questions. Senator Ziegler, you have no questions? Thank you very much Mr. Humphreys. Mr. George, do you have any additional comments that you'd like to make? Please join us.

John George: Thank you, I'm John George, the Director of the Division of Insurance. I have no prepared testimony, in fact came here with a blank piece of paper, and I have some questions that have come up from other people's testimony. I don't have any answers, but I think they're things that might want to be considered. My perspective is from regulating insurance companies. And it dawns on me that we have an interesting situation in that the state is an insurance company for some purposes in this, because we're going to offer this annuity product. On the other hand, we're the buyer of the product we're going to pay for it sort of, I mean it's our money that's paying for it. And the ultimate recipient of the benefit could be the insured. But in a normal contract of insurance there is a written contract. It is not changeable by one party, it's changeable by both parties if they agree. In law, you can take your contract to the court and say they are not fulfilling these obligations. As opposed to say, Social Security, which is a government annuity of sorts, but the government changes the terms and conditions whenever it seems that that's appropriate. Either increasing the benefits or increasing the ... (TURN TAPE OVER) ... but it would set out the terms and conditions under which the benefits were payable and how much they were going to receive. This front-end load "carrot" is kind of an interesting deal. It's not really a promise. If an insurance company said, "Well, we may do this for you, we're not sure if we're going to do this or not," we obviously would not allow that. They can either induce someone by saying we are going to offer this, we will put in this much money and you will get the benefit of it, or they will not do it. To ask people to make the decision as to whether to take the money in cash now, or to take the annuity, based on something we're maybe going to do, but we're not going to tell you if we're going to do it, and besides that we're not binding ourselves next year from what we did this year. So it seems to me that if you were an insurance company, I'd probably say if you're going to offer that carrot, then it must be mandatory, it must

be in the contract, and once done, that's it. I don't regulate the state. The state can do whatever it wants. If you were an insurance company that's what I would do. But I think it's maybe beneficial to point that if you're going to act like an insurance company those are the things that the competition would have to do. And it may be something you want to consider whether the state wants to have a written, binding contract that the legislature can't change, the administration can't change, the courts can interpret. Or are we going to have a statute that is subject to change. What are these people's absolute rights? When they say we're not going to have that program any more ... I guess those are my real thoughts as I've heard other people testify today. I really have no position. As far as I'm concerned, the state is in a position that it is not subject to insurance regulation. If you do contract with an annuity company, an insurance company, I do regulate them, and I suppose we'd have to decide whether the people actually got an insurance contract, an annuity contract from the Equitable. Then I suppose I do regulate the performance under that contract. But if the Equitable were administering the contract, but it's really the state's money and the state's saying, "You take care of the paperwork. When people apply you pay out on this benefit schedule." Then I suppose it would obviously not be regulated. And it may be that when you ultimately decide what ... if you would put a short sentence in there to say that no matter how this is administered it is not subject to AS 21 the insurance code it might relieve some problems of that in the future. My last comment is that Alaska is a very young population and I think when young people think of shall I buy an annuity for my retirement or shall I take money that I can buy whatever with today - a new car, or beer, or whatever they want - the young population is going to take the money. The older people are going to lean toward the annuities. And I think that when you look at our average age, that that may indeed affect how many people participate in the annuity differently than it would your average retirement program, for instance, where people are thinking retirement, and I perceive that people may look at a cash distribution somewhat as the permanent fund distribution. And that's mine to spend instead of saving for my rainy day. Those are my comments. If you have any questions I'd be happy to answer them.

Senator Rodey: Your points are well taken. I think it's important that whatever we do that it be very clear to the public precisely what we're doing, and what the effects are, and not provide something that's

uncertain - surprises should be reserved for
birthdays and Christmas. Thank you, Mr. George.
Is there anyone here today that would like to make
some additional comments or provide some testimony
to the committee. If there is not, the committee is
adjourned.