

ALASKA LEGISLATURE COMMITTEE FILES 1991-1992 8672

7001 HOUSE JUDICIARY

General Information on Hardship Withdrawals
from The Deferred Compensation Plan (DCP)
State of Alaska

Before completing the enclosed forms, please read Section C.2. of Article V., page 13 of the State of Alaska DCP Information Booklet (copy enclosed). It defines what an unforeseeable emergency is in general terms. It also specifies that payment may NOT be made to the extent that such hardship is or may be relieved by:

1. Reimbursement or compensation by insurance or otherwise; or,
2. Liquidation of the participant's assets, to the extent the liquidation of such assets would not itself cause severe financial hardship; or,
3. Cessation of deferrals under the Plan.

If you feel you qualify for a withdrawal under the above conditions, please complete the enclosed Hardship Withdrawal Application and the Financial Data Report. You should describe your hardship in detail on the application form including any effort you have already made to solve the problem. Any pertinent documentation (invoices, billings, statements, etc.) should accompany your completed application and financial report.

Revised 4/89

Deloitte & Touche

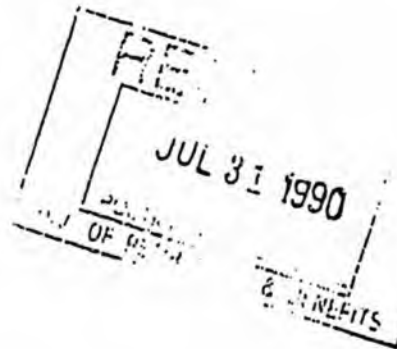


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July 26 1990

Mr. Michael B. Coughlin
Deputy Director
Division of Retirement & Benefits
State of Alaska
Department of Administration
6th Floor, State Office Building
P.O. Box CR
Juneau, Alaska 99811



Subject: Hardship Withdrawals, Deferred Compensation Plan

Dear Mike:

We were finally able to follow-up with the IRS regarding the treatment of divorce related hardship withdrawal requests. Tom Veal of our Washington Service Center was talked with Tom Brisendene of the IRS who oversees the area that regulates the enforcement of Section 457 Deferred Compensation Plans. Mr. Brisendene confirmed what we learned and reported to you earlier that the expenses related to divorce do not qualify as a hardship (unforeseen emergency). He indicated that only under the most extraordinary of conditions could such expenses be treated as an unforeseen emergency (e.g. Divorce expenses arising at the same time their home was struck by lightning).

If you need any further information, please let me know.

Sincerely,

Patrick L. Pechacek

PLP/rcj

ARTICLE V. PAYMENT OF BENEFITS

C. Hardship Withdrawals for an Unforeseeable Emergency

1. General

In the event of an unforeseeable emergency which is beyond the control of the Participant and which causes extreme financial hardship, a participant may request the Administrator to distribute all or a portion of the Participant's Deferred Compensation. Such request shall be made by completing and submitting all required forms for this purpose. The Participant must, prior to his application, cease deferring Compensation in accordance with Paragraph F of Article III. If the application for the payment is approved by the Administrator, payments shall be effected as soon as possible after the date specified in the Participant's application or the date of approval by the Administrator, if later.

2. Unforeseeable Emergency Defined

The term "unforeseeable emergency" is defined to be severe financial hardship to the Participant resulting from a sudden and unexpected illness or accident of the Participant or of a dependent of the Participant, loss of the Participant's property due to a casualty or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the Participant. The circumstances that will constitute an unforeseeable emergency will depend upon the facts of each case, but, in any case, payment may not be made to the extent that such hardship is or may be relieved

- (a) through reimbursement or compensation by insurance or otherwise,
- (b) by liquidation of the Participant's assets, to the extent the liquidation of such assets would not itself cause severe financial hardship, or
- (c) by cessation of deferrals under the Plan

Examples not considered to be unforeseeable emergencies include the need to send a Participant's child to college or the desire to purchase a home.

3. Demonstration of Need

A Participant requesting a hardship withdrawal by reason of an unforeseeable emergency must clearly demonstrate that the circumstances being experienced were not under the Participant's control and constitute a real emergency which is likely to cause the Participant great financial hardship. The Administrator may require such medical, financial or other evidence deemed appropriate to make a determination concerning the Participant's withdrawal request.

4. Limit

The withdrawal shall be limited to an amount sufficient only to meet the emergency and shall in no event exceed the value of the Participant's Deferred Compensation account. Any money remaining in the account shall be distributed in accordance with the provisions of this Plan

5. Method of Distribution

The method of distribution of any allowed withdrawal shall be determined by the Administrator.

the State's doing so is conditioned only upon the State's incurring a need for the services, or the availability of funds or both.

(ii) *Special rule.* Notwithstanding subdivision (i), if, with respect to amounts payable to a participant who is an independent contractor, a plan provides that—

(A) No amount shall be paid to the participant before a date at least 12 months after the day on which the contract expires under which services are performed for the State (or, in the case of more than one contract, all such contracts expire), and

(B) No amount payable to the participant on that date shall be paid to the participant if, after the expiration of the contract (or contracts) and before that date, the participant performs services for the State as an independent contractor or an employee.

The plan is considered to satisfy the requirement described in subparagraph (1) that no amounts payable under the plan will be paid or made available to the participant before the participant separates from service with the State.

(4) *Unforeseeable emergency.* For purposes of this paragraph (h), an unforeseeable emergency is, and if the plan provides for payment in the case of an unforeseeable emergency must be defined in the plan as, severe financial hardship to the participant resulting from a sudden and unexpected illness or accident of the participant or of a dependent (as defined in section 152(a)) of the participant, loss of the participant's property due to casualty, or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant. The circumstances that will constitute an unforeseeable emergency will depend upon the facts of each case, but, in any case, payment may not be made to the extent that such hardship is or may be relieved—

(i) Through reimbursement or compensation by insurance or otherwise.

(ii) By liquidation of the participant's assets, to the extent the liquidation of such assets would not itself cause severe financial hardship, or

(iii) By cessation of deferrals under the plan.

Examples of what are not considered to be unforeseeable emergencies include the need to send a participant's child to college or the desire to purchase a home.

(5) *Emergency withdrawals.*

Withdrawals of amounts because of an unforeseeable emergency must only be permitted to the extent reasonably needed to satisfy the emergency need.

(i) *Distributions of deferrals—(1) Commencement of distributions.* A plan is not an eligible plan unless under the plan the payment of amounts deferred will commence not later than the later of—

(i) 60 days after the close of the plan year in which the participant or former participant attains (or would have attained) normal retirement age (within the meaning of § 1.457-2(f)(4)), or

(ii) 60 days after the close of the plan year in which the participant separates from service (within the meaning of §§ 1.457-2(h) (2) and (3)) with the State. A plan is not other than an eligible plan merely because, prior to October 27, 1982, the distribution of amounts deferred under the plan may commence no later than the close of the participant's taxable year in which the participant attains age 70½.

(2) *Limitations on distributions.* Distributions must be made primarily for the benefit of participants (or former participants). Thus, the schedule selected by the participant for payments of benefits under the plan must be such that benefits payable to a beneficiary are not more than incidental. For example, if provision is made for payment of a portion of the amounts deferred to a beneficiary, the amounts payable to the participant or former participant (as determined by use of the expected return multiples in § 1.72-9, or, in the case of payments under a contract issued by an insurance company, by use of the mortality tables of such company), must exceed one-half of the maximum that could have been payable to the participant if no provision were made for payment to a beneficiary.

(3) *Distributions to beneficiaries.* A plan is not an eligible plan unless the plan provides that, if the participant dies before the entire amount deferred is paid to the participant, the entire amount deferred (or the remaining part of such deferrals if payment thereof has commenced) must be paid to a beneficiary over—

(i) The life of the beneficiary (or any shorter period), if the beneficiary is the participant's surviving spouse, or

(ii) A period not in excess of 15 years, if the beneficiary is not the participant's surviving spouse.

(j) *Administration of plan.* A plan is not an eligible plan unless all amounts deferred under the plan, all property and rights to property (including rights as a beneficiary of a contract providing life insurance protection) purchased with the amounts, and all income attributable to the amounts, property, or rights to property, remain (until paid or made available to the participant or

beneficiary under the plan) solely the property and rights of the State (without being restricted to the benefits under the plan) subject to the claims of the general creditors of the State only. However, nothing in this paragraph (j) prohibits a plan's permitting participants to direct, from among different modes under the plan, the investment of the above amounts (see § 1.457-1(b)).

(k) *Plan-to-plan transfers.* The plan may provide for the transfer of amounts deferred by a former participant to another eligible plan of which the former participant has become a participant if the following conditions are met—

(1) The entities sponsoring the plans are located within the same State (as that term is used in § 1.457-2(c)(1)).

(2) The plan receiving such amounts provides for the acceptance of the amounts, and

(3) The plan provides that if the participant separates from service in order to accept employment with another such entity, payout will not commence upon separation from service, regardless of any other provision of the plan, and amounts previously deferred will automatically be transferred.

(l) *Effect on plan when not administered in accordance with paragraphs (c) through (k).* A plan that is administered in a manner which is inconsistent with one or more of the requirements of paragraphs (c) through (k) of this section ceases to be an eligible plan on the first day of the first plan year beginning more than 100 days after the date of written notification by the Internal Revenue Service that the requirements are not satisfied, unless the inconsistency is corrected before the first day of that plan year.

(m) *Examples.* The provisions of this section may be illustrated by the following examples:

Example 1. A, born on June 1, 1917, is a participant in an eligible State deferred compensation plan providing a normal retirement age of 65. The plan provides limitations on deferrals up to the maximum permitted under § 1.457-2 (e) and (f).

For 1979, A, who will be 62, is scheduled to receive a salary of \$20,000 from the State. A desires to defer the maximum amount possible in 1979. The maximum amount that A may defer under the plan is the lesser of \$7,500, or 33½% of A's includible compensation (generally the equivalent of 25 percent of gross compensation). Accordingly, the maximum that A may defer for 1979 is \$5,000 (\$5,000 = \$20,000 × .25). Although A's taxable year 1979 is one of A's last 3 taxable years before the year in which A attains normal retirement age under the plan, A is not able to utilize the catch-up provisions of § 1.457-2(f) in 1979 because only taxable

THIS WAS THE BALLOT QUESTION NOVEMBER, 1986.

THE VOTE WAS: 99,222 FOR; 65,789 AGAINST.

Ballot Language For
Advisory Vote on Longevity
Bonus Annuity Program

The Fourteenth Alaska State Legislature considered two alternatives to the present longevity bonus program. Both were adopted into law, but neither will take effect unless the legislature chooses one of them. The legislature has asked for an advisory vote of the public on the annuity option which is described below.

The annuity option provides that every individual who reaches age 65 by January 1, 1988, including those already receiving the bonus, would receive a longevity bonus payment of \$250 per month. In addition, a person under age 65 on January 1, 1988, could participate in an optional annuity program by depositing all or part of his or her permanent fund dividends in an account held by the state. Upon reaching age 65, a person would receive a monthly payment in an amount determined by how much was contributed to the account. The annuity payments would be supplemented with declining longevity bonus payments paid for with general funds until the annuity accounts were large enough to provide monthly payments of \$250 a month.

The second option provides that every individual who is 65 years old by January 1, 1988, including those already receiving the bonus, will receive a longevity bonus payment of \$250 per month, but that anybody younger than age 65 by January 1, 1988, would not be eligible for benefits.

Should the legislature adopt the annuity option?

YES () NO ()

②

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REPORT
TO THE FOURTEENTH LEGISLATURE - FIRST SESSION
AND
TO GOVERNOR BILL SHEFFIELD
FROM
THE STATE SPECIAL COMMITTEE ON THE
ALASKA LONGEVITY BONUS PROGRAM



February 1, 1985

REPORT TO THE FOURTEENTH LEGISLATURE - FIRST SESSION
AND TO GOVERNOR BILL SHEFFIELD FROM THE STATE SPECIAL
COMMITTEE ON THE ALASKA LONGEVITY BONUS PROGRAM

together with

DISSENTING VIEWS AND ADDITIONAL COMMENTS

February 1, 1985

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Introduction.

In June, 1984, the Alaska Longevity Bonus Program (AS 47.45) was declared unconstitutional because it required recipients to have resided in Alaska both prior to statehood and for 25 consecutive years. The Thirteenth Legislature, 2nd Sess., repealed these lengthy residency requirements, thus opening the program to new participants. Ch. 38, SLA 1984. However, the amended law, by its own terms, is to be repealed effective June 30, 1985. Id., Sec. 11.

The legislation also established the State Special Committee on the Alaska Longevity Bonus Program to "determine the feasibility of replacing the longevity bonus program, as amended by this Act, with an annuity program, a needs-based program, or other longevity program." Id., Sec. 7. This is the committee's report.

Recommendation: Annuity Approach.

The committee has developed a proposal which would phase out the existing longevity bonus program and replace it with individual annuity accounts funded primarily by the permanent fund dividends of participants. 1/ The proposal has been

1/ Three different annuity approaches were initially considered by the committee: (1) SB 465, introduced in the 1984 legislature by several senators; (2) an amended version of HB 700, also introduced in that legislature; and (3) a draft bill prepared by Senator Bill Ray (D., Juneau). The Ray bill became the vehicle for the Committee's proposal. All three proposals involved

legislature may, at least in the early years, "front-load" the program by appropriating additional funds into the annuity account, which will be attributed to individual accounts on a prescribed formula. Under that formula, state contributions are greatest for those approaching retirement age, and decline for younger Alaskans. Beginning at age 65, a participant receives an annuity based on his contributions and any front-loading -- plus earnings accumulated on those amounts. 3/

Even with front-loading, it will be years before annuity payments are sufficient to replace the longevity bonus. The ALB program is thus retained at a level which, for those turning 65 after 1985, will be reduced annually. 4/ Under the bill, a "target amount" for the ALB is established (Section 8), which is \$250 per month (in FY 1986) inflated by 3% each year. That target amount is then reduced by the maximum possible annuity which would be available to a 65-year old who has participated in

earlier annuity bills, which required an election to forego cash payment. Because, in the future, the annuity program will be the only state source of non-need-based retirement assistance, the committee believes that each Alaskan should be required to come to grips with the long-term consequences of a decision to take the dividend in cash.

3/ Under the committee bill a participant who dies before age 65 will forfeit his accumulated annuity credits (see the discussion of survivor options at 17, post); the amounts forfeited will be reallocated to surviving participants and thus will increase their annuities.

4/ The longevity bonus itself is, of course, available to all elderly Alaskans whether or not they have also established annuity accounts.

Maximum Possible Annuity 5/ ALB (for all new recipients)

1986	4.37	\$245.63
1990	32.50	248.88
1995	106.27	219.92
2000	255.70	122.45
2005	533.39	-0-

Other Options Considered

The committee invited its members, and others, to suggest alternatives other than an annuity program. Only one was advanced -- a "means test" program under which elderly Alaskans earning less than \$25,000 per year would receive a payment of \$250 per month. Those earning more than \$25,000 would receive a payment of \$100 per month. To qualify for the \$250 bonus, the applicant would be required to submit his or her tax return to the Department of Administration.

This program is intended as a permanent replacement for the ALB. However, the program envisions that the size of the payments, and the \$25,000 income limit, remain constant over the years. In terms of real income, the effect is as follows:

5/ Annuity projections are without "front-loading."

CORRECTION

**THIS DOCUMENT
HAS BEEN REPHOTOGRAPHED
TO ASSURE LEGIBILITY**

Introduction.

In June, 1984, the Alaska Longevity Bonus Program (AS 47.45) was declared unconstitutional because it required recipients to have resided in Alaska both prior to statehood and for 25 consecutive years. The Thirteenth Legislature, 2nd Sess., repealed these lengthy residency requirements, thus opening the program to new participants. Ch. 38, SLA 1984. However, the amended law, by its own terms, is to be repealed effective June 30, 1985. Id., Sec. 11.

The legislation also established the State Special Committee on the Alaska Longevity Bonus Program to "determine the feasibility of replacing the longevity bonus program, as amended by this Act, with an annuity program, a needs-based program, or other longevity program." Id., Sec. 7. This is the committee's report.

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1/ Three different annuity approaches were initially considered by the committee: (1) SB 465, introduced in the 1984 legislature by several senators; (2) an amended version of HB 700, also introduced in that legislature; and (3) a draft bill prepared by Senator Bill Ray (D., Juneau). The Ray bill became the vehicle for the Committee's proposal. All three proposals involved

introduced in this legislature as SB 56. Under the committee bill, Alaskans who choose to participate in the program will receive monthly benefits, after reaching age 65, of at least the \$250 which is currently provided by the bonus program, inflated by three percent annually.

The program is available to those who reach age 65 after 1985. Under the bill, Alaska's existing elderly will receive their current \$250 bonus, inflated by three percent annually, without having to forego their permanent fund dividends.

The committee bill provides that each year every Alaskan (except those who are 65 or older before 1986) will receive his or her permanent fund dividend in the form of a credit to an annuity account, unless the individual affirmatively elects to receive cash. 2/ Section 2 of the bill envisions that the

foregoing a permanent fund dividend in return for some type of future annuity benefit.

SB 465 would have paid \$16.50 per month to each elderly Alaskan for every permanent fund dividend foregone -- to a limit of \$250 per month.

HB 700 would have given each Alaskan one annuity share for each foregone dividend. Each year, one third of the money available for permanent fund dividends would then be divided by the number of annuity shares held by those over the age of 65. Each elderly Alaskan would receive a portion of that annuity fund commensurate with the number of shares held.

The committee was advised by legal counsel that HB 700 and SB 465 created greater constitutional risks than did the Ray proposal; the committee therefore focused on the concept embodied in Senator Ray's bill.

2/ This aspect of the committee proposal reflects a change from

legislature may, at least in the early years, "front-load" the program by appropriating additional funds into the annuity account, which will be attributed to individual accounts on a prescribed formula. Under that formula, state contributions are greatest for those approaching retirement age, and decline for younger Alaskans. Beginning at age 65, a participant receives an annuity based on his contributions and any front-loading -- plus earnings accumulated on those amounts. 3/

Even with front-loading, it will be years before annuity payments are sufficient to replace the longevity bonus. The ALB program is thus retained at a level which, for those turning 65 after 1985, will be reduced annually. 4/ Under the bill, a "target amount" for the ALB is established (Section 8), which is \$250 per month (in FY 1986) inflated by 3% each year. That target amount is then reduced by the maximum possible annuity which would be available to a 65-year old who has participated in

earlier annuity bills, which required an election to forego cash payment. Because, in the future, the annuity program will be the only state source of non-need-based retirement assistance, the committee believes that each Alaskan should be required to come to grips with the long-term consequences of a decision to take the dividend in cash.

3/ Under the committee bill a participant who dies before age 65 will forfeit his accumulated annuity credits (see the discussion of survivor options at 17, post); the amounts forfeited will be reallocated to surviving participants and thus will increase their annuities.

4/ The longevity bonus itself is, of course, available to all elderly Alaskans whether or not they have also established annuity accounts.

the program in each year since the program's inception. For example, if the inflated ALB "target" for a particular year is \$280, and a person turning 65 who received an annuity credit in each year of the program would be entitled to an annuity of \$100 per month, the ALB payment for all recipients would be \$180. That \$180 will not vary according to the actual participation histories of individual ALB recipients.

Over the years, individual annuity accounts will become greater, and each year the longevity bonus payable to new recipients becomes correspondingly smaller. By the year 2003, the committee projects that the maximum possible annuity will be sufficient to bring an end to the general-funded ALB program, except for those relatively few who were 65 or older before 1986, and are still receiving ALB payments in that year. This is best illustrated by the following chart:

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Maximum Possible Annuity 5/ ALB (for all new recipients)

1986	4.37	\$245.63
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Other Options Considered

The committee invited its members, and others, to suggest alternatives other than an annuity program. Only one was advanced -- a "means test" program under which elderly Alaskans earning less than \$25,000 per year would receive a payment of \$250 per month. Those earning more than \$25,000 would receive a payment of \$100 per month. To qualify for the \$250 bonus, the applicant would be required to submit his or her tax return to the Department of Administration.

This program is intended as a permanent replacement for the ALB. However, the program envisions that the size of the payments, and the \$25,000 income limit, remain constant over the years. In terms of real income, the effect is as follows:

5/ Annuity projections are without "front-loading."

	<u>Maximum Income Eligibility for Bonus (year)</u>	<u>Amount of Bonus</u>	<u>Size of Alternate Bonus</u>
1986	\$25,000	\$250	\$100
2000	\$10,569	\$104	\$41.60
2010	\$ 5,902 <u>6/</u>	\$ 59	\$23.60

It is estimated that, initially, 80% of Alaska's elderly will be eligible for the \$250 bonus. Because that maximum income requirement drops each year in terms of real income, so too does the percentage of eligible elderly. Thus, less than half of Alaska's elderly will be eligible for the bonus in the year 2000, and only 30% will be eligible in the year 2010.

The committee rejected this means test proposal for the following reasons:

1. Any welfare program is contrary to the intent of the ALB program and is vigorously opposed by Alaska's elderly. The Longevity Bonus Program now says to Alaska's elderly that they are a precious human resource, and that it is in the state's interest to provide them with the wherewithall to remain in Alaska after retirement. The means test payment, on the other hand, carries with it quite different, and less favorable connotations.

6/ This is below Alaska's \$7032/year poverty level.

2. Of those who are potentially eligible for the \$250 means test payment, many may not apply because of its welfare connotations. This is strongly suggested by available statistics. Currently, nearly 6,700 ALB recipients -- or 40% of all recipients -- have incomes below the current eligibility limit for existing Old Age Assistance and Medicaid benefits. These benefits are substantial -- averaging \$2,640 per year for OAA and an additional \$2,500 per year for Medicaid. Yet, of the income-eligible, only 2,526 -- or roughly 38% -- have in fact applied for OAA and Medicaid. Certainly, some of the remaining income-eligible have not applied because they have more assets than current law allows. Nonetheless, these statistics manifest an aversion to need-based assistance which has deterred many of Alaska's apparently eligible elderly from applying for substantial benefits.

3. Thus, while 20% of Alaska's elderly will be ineligible for the \$250 bonus, an additional percentage of existing ALB recipients will lose their current benefits because of their unwillingness to participate in a welfare program. For these reasons, this means test proposal fails a threshold test which should be a cornerstone of any longevity bonus legislation. Any ALB alternative, the committee believes, should provide those who have received the ALB over the years with the same benefits as under current law.

4. The proposal hurts both existing and new ALB recipients in another way. Because the real value of both the benefits and

the income ceiling will decrease over the years, fewer elderly will find themselves eligible, and those who are eligible will receive smaller benefits. By the year 2000, for example, less than half of Alaska's elderly will be eligible for a benefit with a real value of \$104 per month, while the majority will receive a token payment with a real value of \$41.60.

5. The proposal is substantially more expensive than the committee bill. Even though: (1) the committee bill protects existing elderly, while this means test proposal does not; and (2) the committee bill inflates the ALB annually, while the means test proposal does not, enactment of this means test proposal would cost nearly \$2 billion more than the committee bill over the next 50 years. Moreover, that cost would be born when the state could least afford it -- after the turn of the century, when oil revenues are projected to rapidly decline. It is important to the committee to develop an ALB alternative which phases out general fund obligations after the year 2000. As part 12 of this report discusses, while post-1999 costs under the committee bill are projected to be \$285 million, 21st century costs under the means test proposal would be roughly \$2.28 billion.

6. The committee has several concerns regarding the \$100 payment for which all elderly would be eligible. First, the committee does not know what that payment is intended to accomplish. It is doubtful that \$100 per month is a sufficient sum to allow any elderly to remain in the state who would

otherwise be financially required to leave. The payment may thus at once be too small to accomplish any social goal, and yet large enough to constitute a substantial drain on the state treasury.

Additionally, many elderly may view the \$100 payment as tokenism. If that is not the case now, it will certainly become so in the future when the real value of that payment shrinks to \$41 (2000) and \$23 (2010).

Finally, since the \$100 and \$250 payments are fundamentally different in purpose, the committee believes that they should be administered under separate programs. The \$100 payment is apparently intended as a residual ALB. On the other hand, the \$250 payment is a form of welfare. This payment, the committee believes, should be administered by the Department of Health and Social Services under the state's welfare laws. Otherwise, the state will, in essence, be creating two welfare bureaucracies -- one for Old Age Assistance, and one for the mis-named "longevity bonus."

7. Fewer people will meet the \$25,000 eligibility requirement as the years go by. Thus, by the year 2010, only 30% of Alaska's elderly will be eligible for this means test payment. Why, it might fairly be asked, are 80% of today's elderly in "critical" need of the higher payment, while only 30% will require the payment in years hence? For one who is currently denied the larger payment, or who may be denied it in the future solely because of inflation, this precise question will invariably be asked, and may be asked in the courts.

8. Finally, in requiring one year's residency in order to receive the \$250 means test payment, the proposal raises a substantial constitutional issue. The current ALB's one-year durational residency requirement is constitutional because the bonus is not dependent upon "need." Under both the federal and Alaska constitutions, if a program provides "the basic necessities of life," a 30-day residency requirement is the maximum constitutionally permissible. Memorial Hospital v. Maricopa County, 415 U.S. 250, 259 (1974); Shapiro v. Thompson, 394 U.S. 618 (1969). Generally, benefits which are accorded on the basis of the recipient's income tend to be viewed by the courts as involving "basic necessities." For example, in Jeffrey v. Colorado State Department of Social Services, 599 P.2d 874 (Col. 1979), the Colorado Supreme Court struck down the lengthy durational residency requirement of that state's old age pension program, and held that the program provided basic necessities of life. The state argued, unsuccessfully, that its program was more akin to an income supplement, rather than a form of welfare. The court, however, ruled that because the size of the pension was a function of the applicant's other income, a 30-day residency requirement was required:

[The state] attempt[s] to avoid the strict scrutiny - compelling state interest test mandated by Shapiro by characterizing the old age pension program as an 'annuity.' However, unlike true annuity or pension programs which are unaffected by a recipient's other income, the old age pension benefit is directly and proportionately reduced by the amount of other income. Thus, the characterization of the old age pension program as an "annuity" puts form over substance and

disregards the nature of the program, which is to fulfill basic needs and not to supplement separate income.

599 P.2d at 879. Emphasis added.

The means test proposal has been defended because of its high income limits. This does make the program different from that involved in Jeffrey, and the committee agrees that this defense could be made in good faith. To the committee, however, that is not enough. Early in the committee's deliberations, the committee agreed to develop a proposal which would avoid serious new constitutional issues and the threat of continued litigation. While any legislation which treats some people differently than others may result in litigation, the means test proposal raises a serious and substantial residency discrimination issue, and therefore does not meet the committee's goal. 7/

For these reasons, the committee does not believe that the means test proposal is a viable alternative to the existing ALB program.

The committee was also aware of the "stair-stepping approach," under which the ALB program is slowly phased out through an annual increase in the eligibility age. Under legislation which passed the House of Representatives during the

7/ Additionally, it should be noted that the issue will become more serious in future years. This is because while the income level is high at the outset, it shrinks dramatically, and in real value falls below the state's existing poverty level in the year 2008.

previous legislature, the eligibility age would begin to rise above 65 in 1991. Although no "stairstepping" proposal was ever advanced by anyone for formal committee review or action, the committee is aware of some continued interest in developing this concept outside of this committee's deliberations. The proposal thus warrants some comment.

First, the term "stairstepping" is a misnomer, since it connotes a gradual phasing out of the ALB program. In truth, the stairstepping approach causes the most abrupt program termination of any option considered, and also results in the most severe discrimination between groups of Alaskans. Under the stairstepping approach, if a person was born on or before June 30, 1925, the state would pay him or her \$250 per month for life. For persons born on July 1, 1925 and thereafter, the state would pay nothing. And, it is irrelevant whether that person is now an Alaskan. A current non-resident who is now 62 would receive \$250/month when he or she moved to Alaska, while a current 59-year old Alaskan would receive nothing. There is thus nothing gradual, or "stairstepped," about this process.

The stairstepping approach would be more expensive than the committee bill, 8/ and much of this added expense would be born after the turn of the century when the state can least afford it. See Section 12. Yet, despite its high cost, stairstepping would

8/ Assuming, of course, that the two had similar provisions dealing with the erosion of the real value of the bonus.

benefit fewer Alaskans. For example, some have assumed that participation in the annuity program is necessary in order for future elderly to benefit from the committee bill. This is not true. Under stairstepping, a person turning 65 in 1991 would receive no ALB whatsoever, while that same person would receive a 1991 ALB of \$222.61 under the committee bill, even if that person had never participated in the annuity program. Thus, for similar total costs, and substantially lower 21st century costs, the committee bill extends the benefits of the ALB program to many more Alaskans.

Most fundamentally, the committee believes that there is a need for future state participation in the building of retirement security that is not recognized in the stairstepping approach standing alone. Apart from the ALB, the principal form of non-need based assistance is, of course, Social Security. Yet Alaska's elderly receive the same Social Security payments as those who reside where the cost of living is much lower. Moreover, Alaska has a uniquely high percentage of elderly who are ineligible for Social Security because of a lack of wage-earning history. Thus, in one area of the state -- Northwest Alaska -- 66% of the region's elderly reported the ALB as their principal source of income.

As oil revenues decline, and economic activity in the state becomes more uncertain, it is entirely possible that the state's future elderly will find themselves in a more precarious position

than today. And, at that point, the state -- for these same economic reasons -- may be unable to help.

One obvious impact of abolishing the ALB program through "stair-stepping" is an increased Old Age Assistance case load. Certainly, when those near the poverty line are denied \$250 per month, they will simply turn to the welfare system, and the state will realize no net saving. Moreover, and as discussed previously, many ALB recipients who are apparently eligible for OAA and Medicaid have in fact not applied for these benefits. Over the years, the ALB program has been defended on the ground that it has enabled many Alaskan elderly to remain off the welfare roles. Statistics bear this out, indicating that many of those ALB recipients who are eligible for OAA and Medicaid have been able to remain off these programs because of the bonus.

For these reasons, stair-stepping by itself is also not being recommended to the legislature.

On the other hand, the principal advantage of "stair-stepping" is the protection which it affords those who are currently on the ALB program, and who have come to rely on both the Longevity Bonus and the permanent fund dividend to sustain themselves. The committee concluded that forcing Alaska's existing elderly to forego their Permanent Fund Dividend in order to assure continued receipt of the "target" Longevity Bonus might work a hardship on these older Alaskans. As a result, the committee decided to include in the bill a so-called "grandfathering" provision which allows those reaching age 65

before 1986 to take their Permanent Fund Dividend in cash and still receive a full Longevity Bonus for the remainder of their lives. The committee legislation, then, is intended to blend the most salutary aspects of both an annuity approach and "stair-stepping."

The virtue of an annuity approach is that it enables the state and each individual Alaskan to set aside funds now for those perhaps more difficult years ahead. It is a program designed to substitute private thrift for public largesse. The committee also believes that the permanent fund dividend is an appropriate source of funds for the annuity program. The purpose of the annuity program is much like the purpose of the permanent fund itself. Moreover, one purpose of the dividend program -- to give each Alaskan a stake in the management of the permanent fund -- will be enhanced if Alaskans' retirement security is at least in part dependent on wise stewardship of that fund.

Major Features.

1. Front-loading. The committee envisions that the legislature may add additional sums to individual annuity accounts. Under "front-loading," a person will receive an annuity account credit greater -- and perhaps substantially greater -- than the amount of cash he or she could have received. It is the committee's hope that the legislature will consider front-loading for each of the program's first three years.

The committee initially analyzed the annuity concept without front-loading. Even without front-loading, annuity payments eventually replace longevity bonus payments from the general fund. Nonetheless, the committee feared that because annuity payments were low in the early years, those Alaskans who are now near retirement age would not participate in the program. Moreover, general fund contributions did not begin to see significant reductions for about 10 years.

Front-loading provides a substantial incentive to individuals to forego immediate cash in favor of retirement security. While it costs more in the initial years, that cost is incurred in years in which oil revenues are expected to remain high. Moreover, general fund contributions to the ALB program taper off rapidly. In other words, because front-loading causes the maximum possible annuity payment to increase, residual longevity bonus payments decrease more rapidly. Thus, dollars invested in early years through front-loading result in a decrease in general fund obligations in later years.

Under the committee bill, substantial front-loading now would actually result in a net savings over the life of the ALB program -- at least in nominal dollars. Thus, if \$79 million were appropriated for front-loading over the next three years, that investment would result in a return of \$82 million in reduced ALB payments over the next 25 years. In constant 1986 dollars, the ultimate cost of investing \$79 million now is \$30 million.

Additionally, front-loading serves other important purposes which the committee believes warrant the cost in constant dollars:

(1) The committee bill will work only if Alaskans participate. If they do not, Alaska's future elderly may still place demands on the general fund; and

(2) A premium may fairly be placed on the current availability of funds. If \$1.00 of general funds front-loaded now returns 75¢ (in constant dollars) years hence; the fact that the general fund has that \$1.00 now, but may not have the 75¢ later, is of some relevance.

Whether front-loading extends beyond the three-year period envisioned by the committee depends on the availability of funds, actual participation rates, and the projected rate of return on subsequent front-loading investments. If front-loading has succeeded in creating substantial participation, continuation would seem unnecessary, since those Alaskans already in the annuity program would be unlikely to drop out. On the other hand, if participation is low, the legislature may wish to consider inducements other than front-loading.

The committee settled on a front-loading concept weighted in favor of older Alaskans. Several other options were also considered. The first was a per-capita contribution made to each Alaskan who chose an annuity credit. Under this option, the annuity accounts of those near retirement age did not increase enough to substantially increase the "maximum possible annuity."

Thus, it did not significantly reduce long-term general fund obligations. Nor did it satisfy the goal of providing the greatest incentives to those who may need them most.

To better accomplish this goal, the committee next considered a straight \$10 incremental increase in front-loading based on age: that is, participants would receive \$10 for each year that they were older than age 17 -- up to age 65. ^{9/} This option produced a better result in terms of reduced general fund obligations, but it still did not increase annuity payments fast enough to be a significant incentive -- to older Alaskans in particular -- to participate in the program.

Finally, projections were run on the option embodied in the bill: persons 18-34 years old would receive a base amount of front-loading in addition to the dividend -- for example, \$50. Those over 34 would receive a percentage increase (for example, 10%) for each year of age over 34, up to age 65. Under this option, front-loading increases on a curve rather than a straight line -- increasing dramatically as an individual approaches age 65. Thus, a \$50 base with 10% per year increases results in a 34 year old receiving \$50, a 50 year old \$211, and a 64 year old approximately \$800.

The incentive to join the program, then, increases dramatically as retirement age approaches. It is this aspect

^{9/} Thus, an 18 year old would receive \$10, a 38 year old \$210, and a 65 year old \$480.

which is most appealing to the committee, for the following reasons:

First, older Alaskans are most in need of incentives to participate. Because initial annuity payments are small, many may be tempted to take a cash payment which is larger than the annual annuity which it will yield. Then, years later, that person will suffer materially reduced benefits because of that short-sighted decision. On the other hand, younger Alaskans need not participate in the program every year in order to build a sizeable annuity. Based upon projections available to the committee, a 47 year old (in 1986) would be required to participate every year in order to achieve the target annuity when he reaches 65 in the year 2004 -- the year the ALB program disappears. Recognizing that financial circumstances may require a cash election in some years, and that some individuals may be ineligible for a dividend in some years, the committee concluded that additional incentives are appropriate beginning at age 35 in order to help ensure that the maximum possible number of Alaskans will achieve the target annuity.

Second, while older Alaskans will receive more at the outset, the front-loading given younger Alaskans will be invested for a longer period of time. To the extent that the percentage differential is commensurate with account earnings, the eventual return to both old and young will be quite similar.

Finally, this option actually costs less in front-loading dollars than the straight line approach -- even though the now-elderly receive larger amounts.

Two additional points regarding front-loading warrant note. First, and as discussed earlier, under the committee bill those who reach age 65 before 1986 do not participate in the annuity program because they are guaranteed a full longevity bonus for life. As a result, in 1985, there will be no front-loading for any individual over the age of 64. In future years, the incremental increase in front-loading will end at age 65, and those over age 65 will receive the same amount of front-loading as a 65-year-old.

Second, the committee bill envisions that the source of front-loading funds may be the earnings of the undistributed income account of the Alaska permanent fund. In past years, permanent fund earnings have exceeded the amount necessary to pay dividends and inflation-proof the fund itself. The resulting surplus comprises the undistributed income account, which has a current balance of \$557 million. That account itself yields annual earnings which are greater than that necessary to provide front-loading, and which are available for appropriation.

The committee concluded that these earnings are an appropriate source of funds for front-loading for one obvious reason: as with the basic structure of the annuity program itself, this aspect of the bill will devote current permanent fund earnings in a manner which will substantially decrease

general fund obligations in later and perhaps leaner years. Once again, however, only earnings are involved. It must be stressed that nothing in the committee bill in any way impairs the integrity of the permanent fund itself.

2. The 3% Escalator.

Since the beginning of the ALB program in 1972, the original \$100 payment has been periodically increased to its current \$250 limit. While that increase seems large, it has, in fact, roughly kept pace with inflation. If the ALB is retained; the committee believes that it is unreasonable to assume that no increase in the ALB will ever be made. The persistent erosion in the real value of the ALB would at some point become so severe that relief would be necessary. For example, assuming a 6% inflation rate, a \$250 ALB now will be worth only \$104 in 15 years.

There are two ways of dealing with the gradual erosion of the value of the ALB. The first is to leave the problem to future legislatures. The second is the approach taken in the committee bill, which provides a modest 3% annual adjustment intended not to precisely keep pace with inflation, but rather to provide certainty in the amount of the payment.

3. Administrative Costs of the Program. The committee bill provides that the legislature may appropriate funds from the annuity account to pay the administrative costs of the annuity

program. 10/ Thus, the costs of the program will be borne by the annuity participants, whether the funds are privately placed or not.

The bill states that administrative costs will be "equitably allocated" among annuity accounts; it is the committee's intent that an equitable allocation will take into account such factors as numbers of participants, age, and relative account balances.

4. Choice of Benefits. Most annuity programs offer participants a choice of options, such as joint and survivor benefits. The primary reason for survivor benefits in employment annuity programs is that among married couples there is often only one wage earner. Survivor benefits are thus available to insure that the dependent spouse is not left without income. Since the annuity program is available to both spouses, just as is the present longevity bonus program, the committee opted for simplicity and did not include a choice of benefits. 11/

5. Setting the Amount of the Longevity Bonus Payment. Section 8 of the bill provides that the longevity bonus payment -- for those who have not reached 65 before 1986 -- is determined by deducting from that payment the maximum possible annuity

10/ If the states chooses to place the funds with private carriers, any costs shifted to the carrier under the contract would also be paid from the annuity accounts.

11/ A death benefit for those who die prior to reaching age 65 has been included in the Senate State Affairs Committee substitute for SB 56.

available to a person who turns 65 in the year in question. The bill uses the annuity available to a 65-year-old because that annuity is the smallest available (among those who have received the maximum possible credits). A 75-year-old with the identical contribution of a 65-year-old will receive a larger annuity because his life expectancy is shorter, and his capital will be returned faster. Thus, some Alaskans will receive more than the target amount during the early years of the program, and no elderly Alaskans (with full participation) will receive less.

6. Residency Questions. The bill has no residency requirements for receipt of annuity payments. Permanent fund dividends are, of course, only available to Alaska residents -- so that an individual must be an Alaskan to contribute to an annuity account. 12/

7. Federal Income Tax Considerations. Currently, both the permanent fund dividend, and the ALB, are taxable as ordinary income under the Internal Revenue Code. The committee engaged tax counsel to determine whether the result would be any different under the committee bill. Specifically, the committee asked whether a person will be taxable on the cash he could have received as a dividend even though, under the new program, he is only credited with the right to receive a future annuity from the state. Counsel advised the committee that, because the annuity

12/ The longevity bonus program will still require that an individual be a one-year resident to receive a bonus.

program is unique, there is no legal precedent which provides definite answer.

Based on analogous federal tax authorities, tax counsel believes that a crucial factor in determining whether or not an Alaskan receiving an annuity credit will avoid current federal income taxation is the amount with which the legislature "front-loads" the annuity credit in the year the credit is granted. If the legislature provides a substantial front-load to the annuity credit for a particular year, an Alaskan receiving a credit that year should not be subject to tax until annuity payments are actually made on retirement. However, if the legislature provides little or no front-loading in a particular year, there would be a substantial risk that those receiving annuity credits would be taxable immediately on the amount of cash they could have elected in lieu of the credit.

Tax counsel also advised the committee that available precedent does not provide firm guidance on the minimum front-load necessary to support deferred tax treatment of annuity credits. There is an example in the IRS regulations which suggest that a front-load of 25% or more of the annuity credit would be sufficient; however, tax counsel believes that a lesser amount may suffice. Because of this uncertainty, tax counsel suggests that if the committee proposal is enacted, it would be in the state's best interest to obtain an advance ruling from the Internal Revenue Service on the question.

The uncertainty surrounding the tax status of annuity credits, and the substantial risk of taxability when front-loading ends, did not weigh heavily in the committee's recommendation. This is because, at worst, Alaskans would be required to pay taxes on the amount of the dividend just as they do now. Moreover, the committee saw its job as finding an alternative to the ALB program which met the basic goals expressed in this report. It was not charged with simply finding a tax shelter.

Finally, apart from the potential taxability of a permanent fund dividend credited to an annuity account, two favorable tax aspects of the committee proposal should be mentioned:

1. All interest income credited to individual annuity accounts would, under current IRS regulations, be taxable only as it is paid out after reaching age 65; and

2. Front-loading credits would not be currently taxable.

8. Annuity Credits Are Not a Vested Right. The committee bill provides that an individual does not receive a vested or property right to an annuity payment until that payment is made. Funds must be appropriated annually by the legislature from the annuity account to make annuity payments. Although the clear legislative intent of the bill is to provide annuity payments to those who have participated in the program, the committee bill neither binds future legislatures nor creates a dedicated fund. Thus, the legislature may legally appropriate annuity funds for any public purpose. An individual's right to an annuity payment

prior to dispersal is an unfunded, unsecured promise of the state. Thus, a future annuitant is in no better legal position than any unsecured creditor of the state.

As a result, the bill is silent with regard to the garnishment of annuity credits. Prior to annuity payments, there is nothing to garnish or attach, nor anything that can properly be regarded as "income" or an "asset."

9. Protection of Alaska's Existing Elderly. As noted previously, persons who reach the age of 65 before 1986 will not be required to forego their permanent fund dividend in order to receive a \$250 per month Longevity Bonus, inflated 3% annually. The committee decided to integrate this aspect "stair-stepping" because it concluded that many retired Alaskans have come to rely upon both the ALB and the permanent fund dividend, and -- since they are now retired -- would be unable to make adequate arrangements to mitigate the impact of an abrupt denial (or reduction) in either payment.

Under last session's House bill, those who had reached the age of 60 before 1986 would have received a full ALB for life, although the amount of that bonus would not be increased in future years. The committee considered and rejected the option of extending this protection to 60-year-olds for three reasons:

1. Assuming a retirement age of 65, those under that age will have 1-5 years to make necessary arrangements to accommodate either the loss of a cash dividend, or incremental reductions in the ALB payment. Current retirees, on the other hand, a

little or no ability to alter their financial condition. Thus, while any age group might be said to have some "expectancy" to both an ALB and a cash dividend, that "expectancy" is more immediate, and more critical, for existing retirees;

2. Exempting 60-year-olds from the ALB reduction of the committee bill would not simply postpone the inevitable financial disparity between two groups of Alaskans -- it would aggravate it. Under the House bill, the first reduction in payments would occur in 1991. Because of the growth in the "maximum possible annuity" by that time, the initial difference in monthly ALB payments between an exempt recipient, and a non-exempt recipient who did not forego his dividend, would be \$67.21 per month. Conversely, under the committee bill, differential payments will begin in 1986, and will initially be \$11.92 per month. The committee felt that if some smaller differential were felt immediately, the need to begin participation in the program now would be more apparent to non-exempt recipients. In other words, immediate "stair-stepping" may well encourage higher annuity participation, which in turn will reduce the actual differential treatment between exempt and non-exempt recipients; and

3. The ALB program cannot go on forever. Indeed, it has been a goal of the committee to develop a proposal which phases out general fund obligations near the turn of the century -- when oil revenues are predicted to dramatically decline. If the bill were to protect existing 60-year-olds, the committee projects that the state would still be making general-fund ALB payments of

\$74.9 million in the year 2000, and general fund obligations would not end until the year 2029. Moreover, extending the bill's protection to 60-year-olds would cost an additional \$31 million over the life of the program. In drawing the necessary dividing line between those who can continue to receive the full benefits of existing law, and those who cannot, economic feasibility plays an appropriate role. For the reasons above-stated, the committee believes that the line is best drawn at age 65.

10. Possible Participation Rates. The committee attempted to estimate likely participation rates for the legislation's annuity program. Currently, participation rates in certain voluntary employee retirement plans exceed 50%. There are, however, differences between those plans, and the annuity program established by the committee's bill. Under most employee plans, contributed funds can be withdrawn upon termination, or in case of substantial hardship. Under the committee bill, however, no benefits can accrue until retirement. Additionally, high participation rates in employee plans are, in large part, a function of intensive educational efforts which cannot be duplicated on a statewide basis -- particularly in Alaska. Finally, participation rates for employee plans may be irrelevant in predicting participation by the jobless and very poor.

On the other hand, with front loading, matching contributions which participants receive may be, at least for older Alaskans, substantially more than typical matching payment

by employers. Additionally, under any employee plan, an employee must dedicate a portion of his or her regular monthly salary -- each dollar of which may already have been budgeted for regular family needs. The permanent fund dividend, on the other hand, is an irregular source of income which (for some Alaskans) is not a component of the regular family budget, and hence more readily disposable.

Given these differences, and the unique nature of the annuity program established by this bill, the committee does not believe that any meaningful projection, or even range of projections, can be provided.

If participation rates are very high, by the year 2003 state Old Age Assistance payments may be substantially decreased. Indeed, it is conceivable that a successful annuity program could virtually eliminate the need for old age welfare payments. For example, by the year 2010, every elderly Alaskan who has fully participated in the program will be receiving a monthly annuity of \$1,047.88.

On the other hand, if participation is very low, the state may experience increased old age assistance obligations as the residual longevity bonus phases out.

The only way to guard against future increases in OAA clientele is either to maintain the existing ALB program -- an option which the committee believes is cost-prohibitive -- or convert the ALB itself into a form of welfare. Other options studied (including stairstepping) would not simply threaten, but

inevitably lead to higher OAA obligations. The committee bill, on the other hand, offers Alaska's future elderly at least the opportunity to ultimately avoid the need for OAA assistance -- an opportunity which at least some Alaskans will accept. In other words, even with modest levels of participation, the result would be better than under "stair-stepping."

11. Impact Upon Eligibility For Old Age Assistance and Medicaid.

If an elderly Alaskan earns \$586 or less per month, he or she is eligible to receive federal Supplemental Security Income and/or state Old Age Assistance. There are currently some 2,450 elderly receiving this assistance, and the average benefit is \$240 per month.

Elderly who are eligible for OAA are also eligible for Medicaid. Medicaid benefits are accessed by almost half of the OAA recipients, and the average non-nursing home benefit is \$2,500 per year.

If an elderly Alaskan earns less than \$900 per month, he or she is eligible for nursing home benefits under Medicaid. These benefits are substantial -- averaging \$135 per day, or \$50,000 per year for each individual.

Until 1984, and by virtue of a specific exclusion in federal law, ALB payments did not count as "income" in determining eligibility for SSI or Medicaid. See 42 U.S.C. §1982a(b)(2)(B). However, when the ALB program was changed in

1984, Congress also amended the exclusion to protect only those who:

1. are 65 years of age on or before September 30, 1985; and
2. have 25 years of continuous residency in Alaska by that date.

This change in federal law has had the following effect on the SSI, OAA and Medicaid eligibility in Alaska:

1. Some 750 current recipients of OAA will experience a loss or reduction in benefits because they are now eligible to receive the ALB, but fall outside the amended federal exclusion. These individuals have not, however, suffered a net loss in cash benefits, since ALB payments have merely replaced previous OAA/SSI payments. While these individuals are the subject of discrimination, since they cannot retain both their ALB and their previous OAA/SSI benefits (as can long-time Alaskans), that discrimination is solely the product of federal law. If the state undertook to cure this discrimination by replacing lost federal SSI benefits, \$1.4 million would be required for FY 1986.

2. Some 314 of the 750 affected OAA/SSI recipients will also lose non-nursing home Medicaid coverage -- a benefit which averages \$2,500 per year. This is a substantial loss which is not compensated for by the ALB program. The amount of lost federal Medicaid benefits to these 314 individuals is only \$413,847 for FY 1986. The state could therefore compensate for these lost federal benefits at relatively small cost.

3. The most substantial impact of the recent federal 1 change is upon nursing home patients. 36 elderly Alaskans who are currently in nursing homes may lose their Medicaid nursing home coverage as a result of this change. To pay these individuals' nursing home costs entirely through state funds would require a \$720,000 additional appropriation in FY 1986.

The committee bill neither alleviates nor aggravates the problems associated with OAA/SSI benefit reductions, or reductions in non-nursing home Medicaid payments. Unless the legislature were to adopt a needs-based ALB program, virtually any option which the legislature might chose would leave the affected elderly in the same position as under current law. 13/

The committee proposal would, however, probably benefit existing nursing home residents. Under the bill, persons residing in a nursing home are ineligible to receive the ALB. This exclusion, the committee believes, is consistent with and furthers the intent of the ALB program. Its effect is to benefit existing nursing home residents who will lose access to the \$250 a month ALB, but at the same time will retain their eligibility for \$50,000 per year nursing home payments.

13/ Under current federal law, payments which are predicated on need are not counted as "income" for federal assistance purposes. Thus, the means test proposal discussed earlier may avoid the problems discussed in this section -- assuming that federal officials were willing to treat a \$25,000 income limit as truly differentiating the "needy" from the "non-needy."

12. Costs of Various ALB Alternatives. The committee has estimated the costs of various alternatives. Although population figures (and hence program costs) in future years are difficult to predict, several of the alternatives studied -- including the stair-stepping approach and the means test proposal -- envision general fund expenditures well into the next century. The committee felt that it was particularly important to at least estimate costs beyond the year 2000 for two reasons.

First, it has been a goal of the committee to develop a program which phases out general obligations after the turn of the century -- when oil revenues are projected to dramatically decline. Estimating post-2000 expenditures is thus particularly important.

Second, some options envision higher immediate investment in return for lower long term obligations. Others involve smaller near-term expenditures -- an attribute which is paid for in the years to come. A fair comparison, then, can only be made by looking at total expenditures over the life of each alternative.

Chart 1 indicates the costs of making continued ALB payments under four alternatives. This chart assumes that -- whatever program is chosen -- an escalation in the ALB payment will be made as the years go by. As the chart indicates, the cost of continuing the current, expanded ALB program is prohibitive. The second option, the "Annuity Program," reflects the committee bill without grandfathering Alaska's existing elderly. Under this

option, in order to receive the target amount, existing elde. would be required to forego their permanent fund dividends.

The third option -- the "Annuity Program w/1986 Stairstep" -- reflects the ALB costs of the committee bill itself. The "Stairstep" approach refers to last session's legislation, which would begin stair-stepping in FY 1991. Finally, projections on the means test proposal which assume escalation have not been run.

Assuming that the legislature provides a 3% per annum increase in the ALB payment, the ALB costs of the options considered are as follows:

Chart 1

ALB COSTS THROUGH 2034
WITH 3% ESCALATOR (in millions)

	<u>Nominal \$</u>	<u>Constant \$</u>	<u>Present Value</u> ^{14/}
Current Law	13,087	2,501	1,393
Annuity Program	964	605	496
Annuity Program w/1986 Stairstep	1,290	735	584
Stairstep	1,455	745	577
Means Test	N/A	N/A	N/A

^{14/} The term "Nominal \$" is self-explanatory. The term "Constant \$" refers to costs expressed in 1986 dollars -- assuming 6% annual inflation. The term "Present Value" refers to the amount of money which, if invested now, would endow the various options through the duration of each.

Conversely, if the legislature held the amount of the ALB constant over the years instead of providing a regulator escalator, the ALB costs of the option would be:

Chart 2

ALB COSTS THROUGH FY 2034
WITHOUT ESCALATION (in millions)

	<u>Nominal \$</u>	<u>Constant \$</u>	<u>Present Value</u>
Current Law	5,419	1,391	880
Annuity Program	619	432	369
Annuity Program w/1986 Stairstep	864	539	444
Stairstep	1,040	586	470
Means Test	3,199	945.9	634.9

In addition to the general fund costs of (1) continuing the current ALB for existing recipients, and (2) providing a gradually reduced ALB for new recipients, the committee bill envisions that individual annuity accounts will be "front loaded" with funds drawn from the earnings of the undistributed income account of the Alaska permanent fund.

Estimating the costs of "front loading" is a three step process. First, the committee assumed that the legislature would provide sufficient front loading to allow those 35 and younger to receive a \$50 base supplement, and those over 35 to receive a supplement which is increased 10% for each year of age up to 65. Second, the committee assumed that participation rates would be very low in younger Alaskans, and extremely high for those older Alaskans receiving the greatest front-loading. The cost of "front load payments" under those assumptions -- with and without

the grandfathering of existing recipients are reflected in Chart 3.

Finally, the effect of front loading is to more rapidly reduce the "target" ALB, and hence reduce general fund obligations. Thus, the net cost of any front loading must be offset by "ALB savings," which are also reflected in Chart 3:

Chart 3

EFFECT OF 3-YEAR FRONT LOADING
(in millions)

	<u>Nominal \$</u>	<u>Constant \$</u>	<u>Present Value</u>
<u>Annuity Program (3% Esc.)</u>			
Front-Load Payments	113	101	96
(ALB Savings)	(126)	(69)	(31)
Net Cost (Savings)	<u>(13)</u>	<u>32</u>	<u>65</u>
<u>Annuity Program (No Esc.)</u>			
Front-Load Payments	113	101	96
(ALB Savings)	(91)	(57)	(46)
Net Cost (Savings)	<u>22</u>	<u>44</u>	<u>50</u>
<u>Annuity & 1986 Stairstep (3% Esc.)</u>			
Front-Load Payments	79	71	67
(ALB Savings)	(82)	(41)	(31)
Net Cost (Savings)	<u>(3)</u>	<u>30</u>	<u>36</u>
<u>Annuity & 1986 Stairstep (No Esc.)</u>			
Front-Load Payments	79	71	56
(ALB Savings)	(56)	(30)	(23)
Net Cost Savings	<u>23</u>	<u>41</u>	<u>44</u>

The net costs (or savings) of front loading for any particular program can then be added (or subtracted) from the appropriate column of Charts 1-2. From that exercise, it is

apparent that front loading does not materially affect the cost ranking of any of the options considered.

Finally, under stair-stepping, those who do not reach age 65 by FY 1990 will receive no longevity bonus. Of those who are denied the bonus in the future, a portion will apply for state Old Age Assistance. As noted previously, a number of current ALB recipients are apparently eligible for OAA and Medicaid but have not applied because of the bonus. There is thus a segment of Alaska's elderly who are now eligible for OAA and Medicaid, and who might apply for benefits under those programs if the ALB were denied.

It is difficult to predict the number of elderly who would actually turn to state welfare assistance if and when the ALB program were terminated. Currently, one out of every 2.65 income-eligible ALB recipients actually applies for OAA. Under the "moderate low" scenario of Chart 4, one half of those elderly would apply for OAA. Under the "moderate high" scenario, two-thirds of the eligible elderly would apply for assistance once the bonus program were terminated. Cumulative costs, 15/ in increased OAA and Medicaid benefits, through the year 2010 under these two scenarios are as follows:

15/ The cost estimates in Chart 4 should be viewed as substantially equivalent to constant 1986 dollar estimates. Although they are technically nominal dollars, they assume no increase in OAA or Medicaid benefits as the years go by. If one assumes that OAA and Medicaid benefits keep close pace with inflation, these estimates would then better reflect constant

Chart 4

INCREASED CAA/MEDICAID COSTS THROUGH 2010
(in millions)

Moderate Low

81.3

Moderate High

150.2

It is possible that increased OAA costs would also result from the committee bill. Although, under the bill, the ALB is gradually phased out, rather than abruptly terminated, those new elderly who have not participated in the annuity program may eventually find themselves in need of welfare assistance. The degree of that problem, of course, is a function of participation rates -- which are difficult to determine. However, because -- under the committee bill -- the ALB is phased out, rather than abruptly terminated, 16/ and because a portion of Alaska's population will participate in the annuity program, the committee believes that -- even with low participation rates -- the impact of the bill upon old age assistance programs is likely to be less severe than under the stairstepping approach.

Finally, the committee looked at the cost of various options after 1999. As noted previously, it has been a goal of the

dollar costs.

16/ Thus under stairstepping, a person turning 65 in 1991 would receive no ALB whatsoever. On the other hand, under the committee bill, a person turning 65 in 1991, and who has not participated in the annuity program, will still receive a longevity bonus of \$222.61 per month.

committee to develop a longevity bonus program in which general fund obligations would be minimized as oil revenues declined. Chart 5 indicates the cost of stairstepping, the means test proposal and the annuity program with and without stairstepping, which would be incurred in the 21st century:

Chart 5

COSTS INCURRED AFTER YEAR 1999
(in millions: Nominal \$)

<u>3% Escalation</u>	
Annuity Program	69.9
Annuity Program w/1986 Stairstep	285.3
Stairstep	588.3
Means Test	N/A
 <u>No Escalation</u>	
Annuity Program	0
Annuity Program w/1986 Stairstep	128.4
Stairstep	291
Means Test	2,486.2

The Benefit Concept's Proposal

The committee investigated an approach proposed by Benefit Concepts, Inc. and Kidder Peabody & Co., Inc. The proposal is essentially an investment program for endowing the longevity bonus program. That is, a substantial investment (approximately \$350 million) would be made in the initial years of the program, and the return from that investment is estimated to be sufficient

to make the declining longevity bonus payments required under the committee's annuity approach. 17/

Benefit Concepts proposes that the state invest in single premium whole life insurance policies (SPL's) taken out on Alaska's elderly. The state would be the owner and beneficiary of the policies. Benefit Concepts' projections indicate that this type of investment would be superior to other options which they believe would be appropriate for such an investment plan, such as guaranteed investment contracts (GIC's), corporate bonds or government securities.

The Benefit Concepts proposal was analyzed by the actuarial firm of Johnson & Higgins at the committee's request. That firm concluded that (1) the costs of the program may be understated when compared with data used by OMB (see footnote); (2) should the state consider "endowing" the ALB program, it should not limit its choices to the low risk alternatives considered by

17/ Subject to available funds, the state could "endow" any program by investing enough cash to produce the revenue to pay the costs of the program. Indeed, the concept of "endowment" is implicit in the "present value" calculations made by the Office of Management and Budget for the longevity bonus alternatives analyzed. Two points deserve attention. First, in order to avoid dedicated fund problems, the income from any such investment would be deposited in the general fund, and subject to annual appropriation to pay program costs. Second, the assumptions used by Benefits Concepts in making their cost estimates differ in two important respects from the assumptions used by OMB. Benefit Concepts used different population projections, and assumed a different interest environment. Both these differences understate the cost of their proposal when compared with programs using OMB estimates. The committee, therefore, cautions against direct cost comparisons.

Benefit Concepts, but should also examine other investment options; and (3) the primary advantage of the SPL approach over other low risk investments is the substantial tax advantage available to some insurance companies in providing this type of policy. These tax advantages are under scrutiny by the federal Treasury Department, and could well be eliminated through revisions to the Internal Revenue Code in the near future. It would be likely that an insurance company would insist on passing any tax changes through to the policy holder, thus removing the advantage of this type of investment.

The committee is unable to make a firm recommendation regarding this proposal to the legislature but believes that the concept may warrant further consideration by the state's financial experts.

The Alaska Pioneers' Home

On July 30, 1984, Governor Sheffield requested the committee to consider expanding its inquiry to include Alaska's Pioneers' Home Program. Because of time constraints, and the fact that the committee developed an alternative to the ALB program which has no application to the Pioneers' Home, the committee was unable to consider alternatives to this program in any depth.

The committee, however, shares Governor Sheffield's concerns over the program. Under AS 47.25.030, an individual must have resided in Alaska for 15 consecutive years, or 30 total years, in

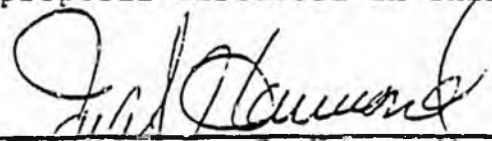
order to be eligible for admission to the homes. Plainly, that requirement raises substantial constitutional questions.

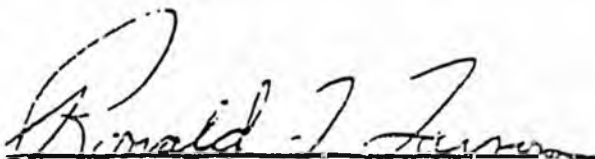
To date, no one has filed suit over the Pioneers' Home eligibility requirements. It is this committee's recommendation that the legislature develop and consider alternatives to the existing residency requirements during this session. The pressure and tension created by the Vest litigation has made it more difficult, over the past 2½ years, to develop a sound replacement for the ALB program. That experience need not, and should not be repeated for the Pioneers' Homes.

One alternative for replacing the current residency requirements warrants note. The legislature may wish to develop a point system that would determine eligibility for Pioneers Home admission based upon the hardship that would be suffered if the applicant were forced to seek housing out of state. Location of home, family and friends would all be relevant to assessing that hardship; yet hard and fast residency rules would be avoided.

Conclusion

The undersigned members of the committee respectfully recommend that the legislature consider and enact the annuity proposal discussed in this report.


Governor Jay S. Hammond


Representative Ronald Larson

Bill Ray
Senator Bill Ray

Olga T. Steger
Olga T. Steger

Valmar M. Kerttula
Senator Valmar M. Kerttula

Robert C. Kallenberg
Robert C. Kallenberg

JAN 12 1985

IN THE _____

BY _____

_____ BILL NO.

IN THE LEGISLATURE OF THE STATE OF ALASKA

FOURTEENTH LEGISLATURE - FIRST SESSION

A BILL

For an Act entitled: "An Act amending the longevity bonus program and the permanent fund dividend program in order to establish an annuity program; and providing for an effective date."

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

* Section 1. FINDINGS AND PURPOSE. The legislature finds and declares that

(1) it is in the public interest to continue the longevity bonus program. However, as oil reserves decline over the years, it will become increasingly difficult to provide the benefits of the longevity bonus program through the general fund. As a result, that program must be phased out over the years;

(2) it is appropriate that individuals save for their own retirement, and it is also appropriate that the state establish both means and incentives for Alaska residents to set aside retirement funds. Accordingly, it is a purpose of this legislation to create an annuity program, and to encourage Alaskans to participate in that program by authorizing general fund supplements which would result in annuity payments which are larger than an individual could earn through private investment of the permanent fund dividend;

(3) many retired Alaskans have made their retirement plans in reliance on the availability of both the existing longevity bonus and the permanent fund dividend. Accordingly, the legislature finds that it is appropriate to continue both those programs for these individuals;

(4) the most suitable source of funds for the annuity program created by this Act are those permanent fund earnings currently distributed as dividends. This Act applies the annual permanent fund dividend of younger Alaskans to annuity accounts unless the individual alternatively elects to receive cash. In so doing, this Act will promote wise stewardship of the permanent fund by giving each participant a direct financial stake in its long-term profitability; and

(5) neither the longevity bonus program, nor the annuity program, should be viewed as a form of welfare. Other state and federal programs are available to meet the basic necessities of life, and amounts received by any individual under this Act are not calculated on the basis of need.

* Sec. 2. AS 43.23.005 is amended to read:

(c) A parent, guardian, or other authorized representative may claim a permanent fund dividend on behalf of an unemancipated minor or on behalf of an incompetent individual who is eligible to receive a dividend [PAYMENT] under this section.

* Sec. 3. AS 43.23.005 is amended by adding a new subsection to read:

(d) A person who is eligible to receive a permanent fund dividend under this section, or who is authorized to claim a dividend on behalf of another under (c) of this section, may elect to receive cash in lieu of an annuity share. Alternatively, a person may elect to receive not less than 25 percent of his dividend in cash and the remainder as an annuity credit. A person exempt under AS 47.45.015(b) will automatically receive cash without the necessity of election.

* Sec. 4. AS 43.23.015 is amended to read:

Sec. 43.23.015. APPLICATION AND PROOF OF ELIGIBILITY. (a) The commissioner shall adopt regulations under the Administrative Procedure Act (AS 44.62) establishing the process for determining the eligibility of individuals for permanent fund dividends. The

commissioner may require an individual to provide proof of eligibility, and the commissioner may use other information available from other state departments or agencies to determine the eligibility of an individual.

(b) The department shall prescribe and furnish an application form for claiming a permanent fund dividend. The application must contain a statement of eligibility and a certification of residency in substantially the following form:

I certify that

() I am a state resident on the date of this application and I have been a state resident for at least six months immediately preceding the date of this application; or

() (name), the individual on whose behalf I am applying, is a state resident and has been a state resident for at least six months immediately preceding the date of this application.

I understand that a false claim of residency to obtain a permanent fund dividend for myself or for another is a criminal offense and that if convicted I will forfeit future permanent fund dividends and that I will lose or must repay all permanent fund dividends that have been credited or paid to me, including any accrued interest in my annuity account. I understand that this penalty is in addition to any criminal penalties imposed.

(signature of individual,
parent, guardian, or other
authorized representative)

(c) Except as provided in (d) of this section or as may be provided by regulations adopted by the department, an individual must personally sign the application for permanent fund dividends,

including the certification of residency required under (b) of this section.

(d) The application and certification of residency of an unemancipated individual under 18 years of age or of an incompetent individual must be signed by the individual's parent, legal guardian, or other authorized representative.

(e) If a public agency claims a cash [PERMANENT FUND] dividend on behalf of an individual under (i) of this section, the public agency shall hold the dividend in trust for the individual. Money held in trust under this subsection shall be invested by the commissioner in accordance with AS 37.10.070.

(f) A minor or an incompetent individual may not maintain a claim against the state or any officer or employee of the state base either on the manner in which the parent, guardian, or authorize representative other than a public agency of the state managed or disposed of permanent fund dividends received on behalf of the minor or incompetent, or any election made or not made on that individual's behalf under AS 43.23.005(d).

(g) If an individual is aggrieved by a decision of the department determining the individual's eligibility for a permanent fund dividend or the individual's authority to claim a permanent fund dividend on behalf of another, the individual may appeal that decision to the superior court in accordance with AS 44.62.560. An appeal under this section does not entitle the aggrieved individual to a trial de novo. The appeal shall be based on the record of the administrative proceeding from which appeal is taken and the scope of the appeal is limited to matters contained in the record of the administrative proceeding.

(h) The penalty and enforcement provisions of AS 43.23.035 apply to an individual who claims a permanent fund dividend on behalf of another.

(i) The permanent fund dividend application form shall be prepared to allow an applicant, other than a person exempt under AS 47.45.015(b), to elect to receive cash in lieu of a permanent fund dividend.

* Sec. 5. AS 43.23.035 is amended to read:

Sec. 43.23.035. PENALTIES AND ENFORCEMENT. (a) In addition to any criminal penalties imposed by state law, if an individual is convicted of a crime in connection with a false statement made in a certification required under AS 43.23.015, and the conviction is not reversed, that individual forfeits all permanent fund dividends credited or paid, together with any additional credits to his annuity account and is not eligible for a future permanent fund dividend.

(b) If the commissioner determines that a cash [PERMANENT FUND] dividend should not have been claimed by or paid to an individual, the commissioner may use all collection procedures or remedies available for collection of taxes under this title to recover the payment of a permanent fund dividend that was improperly made. A notice of an improperly paid dividend must be sent to the individual within 10 years after the improper payment. If notice is not sent within the 10-year period, proceedings may not be commenced in court for recovery of the improper payment.

(c) If the commissioner determines that a permanent fund dividend should not have been credited to an individual's annuity account, the commissioner may after notice and opportunity for hearing, direct the commissioner of administration to debit the individual's annuity account for the amount wrongly credited. If the

credit is the fault of the individual, the debit must be made within 10 years. If the credit is the fault of the state, the debit must be made within three years.

* Sec. 6. AS 43.23.055 is amended to read:

Sec. 43.23.055. DUTIES OF THE DEPARTMENT. The department shall

(1) annually [PAY PERMANENT FUND DIVIDENDS FROM THE DIVIDEND FUND] make payments to exempt individuals under AS 47.45.015(b) and those who elect cash under AS 43.23.005(d);

(2) adopt regulations under the Administrative Procedure Act (AS 44.62) that establish procedures and time limits for claiming a permanent fund dividend or for making election under AS 43.23.005(d); the department shall set the time limit for applications for permanent fund dividends so that the number of eligible applicants is determined by October 1 of the year for which the dividend is declared and permanent fund dividends for a year are paid before April 30 of the year following the year;

(3) adopt regulations under the Administrative Procedure Act (AS 44.62) that establish procedures and time limits for an individual upon emancipation or upon reaching majority to apply for permanent fund dividends not credited or received during minority because the parent, guardian, or other authorized representative did not apply on behalf of the individual; [AND]

(4) assist residents of the state, particularly in rural areas, who because of language, disability, or inaccessibility to public transportation need assistance to establish eligibility and to apply for permanent fund dividends; and

(5) provide the commissioner of administration with information necessary to maintain individual annuity account records and administer the annuity program.

* Sec. 7. AS 43.23.065 is amended to read:

Sec. 43.23.065. EXEMPTION OF PERMANENT FUND DIVIDENDS. (a) Fifty percent of a cash payment received under AS 43.23.005(d) [THE ANNUAL PERMANENT FUND DIVIDEND PAYABLE TO AN INDIVIDUAL] is exempt from levy, execution, garnishment, attachment, or any other remedy for the collection of debt. This exemption applies to an eligible individual's permanent fund dividend both before and after payment is made to the individual. An exemption is not available under this section for cash payments [PERMANENT FUND DIVIDENDS] taken to satisfy (1) child support obligations required by court order or decision of the child support enforcement agency under AS 47.23.140 -- 47.23.220; (2) a debt owed by an eligible individual to an agency of the state, unless the debt is contested and an appeal is pending, or the time limit for filing an appeal has not expired, or (3) court ordered restitution under AS 12.55.045 -- 12.55.051 or AS 12.55.100. A child support obligation under (1) of this section has priority over a debt owed to an agency of the state, and a permanent fund dividend may not be taken to satisfy a debt under (2) of this section until any portion of the dividend necessary to satisfy a child support obligation has been taken.

(b) When an individual owes a past due debt described in (a)(1) of this section, the department shall require that the individual take his or her permanent fund dividend in cash.

(c) The courts of this state may, as a condition of any civil judgment or restitution order under AS 12.55.045 -- 12.55.051 or AS 12.55.100, require the defendant to take his or her permanent fund dividend in cash.

* Sec. 8. AS 43.23.075 is amended to read:

Sec. 43.23.075. ELIGIBILITY FOR PUBLIC ASSISTANCE. (a) In determining the eligibility of an individual under a public assistance program administered by the Department of Health and Social Services in which eligibility for assistance is based on financial need, the Department of Health and Social Services may not consider a permanent fund dividend as income or resources received by the recipient of public assistance or by a member of the recipient's household unless required to do so by federal law or regulation. The Department of Health and Social Services shall notify all recipients of public assistance of the effects of [RECEIVING] a permanent fund dividend credit or cash payment.

(b) An individual who is denied medical assistance under 42 U.S.C. 1396 -- 1396p (Social Security Act, Title XIX) solely because of the credit or receipt of a permanent fund dividend by the individual or by a member of the individual's household is eligible for state-funded medical assistance under the general relief assistance program (AS 47.25.120 -- 47.25.300). The individual is entitled to receive, for a period not to exceed four months, the same level of medical assistance as the individual would have received under 42 U.S.C. 1396 -- 1396p (Social Security Act, Title XIX) had there been no permanent fund dividend program.

(c) An individual who is denied assistance solely because permanent fund dividends credited to or received by the individual or by a member of the individual's household are counted as income or resources under federal law or regulation is eligible for cash assistance under the general relief assistance program (AS 47.25.120 -- 47.25.300). Notwithstanding the limit in AS 47.25.130, the individual is entitled to receive, for a period not to exceed four months, the same amount as the individual would have

received under other public assistance programs had there been no permanent fund dividend program.

* Sec. 9. AS 37 is amended by adding a new chapter to read:

CHAPTER 16: ANNUITY PROGRAM

Sec. 37.16.010. ANNUITY INVESTMENT FUND. (a) The annuity investment fund is established as a separate fund in the state treasury. Notwithstanding the provisions of AS 37.13.145, an amount equal to the permanent fund dividends taken as annuity credits under AS 43.23 shall be annually transferred from the dividend fund to the annuity investment fund.

(b) The legislature may appropriate either general funds, or earnings upon the undistributed income account in the Alaska permanent fund, to the annuity investment fund. Any funds appropriated under this subsection shall be allocated to the individual annuity accounts of those who are eligible to receive a dividend for that year and do not elect cash under AS 43.23.005(d). The allocation shall be made in the following manner:

(1) A credit will be made to the account of each individual who is at least 18 years old;

(2) The credit for each person from the age of 18 through age 35 is the base amount. The size of the base amount is determined according to the amount of the appropriation;

(3) The credit for persons over the age of 35 is the base amount, increased for each year of age over 35 up to and including the age of 65. The incremental increase for each year of age is a percentage over the credit for the prior year of age. That percentage shall be established with due regard for historical and projected permanent fund returns on investment;

(4) If a person elects to receive a portion of his dividend in cash under AS 43.23.005(d), the allocation to which he is otherwise entitled will be proportionately reduced.

(c) Money in the annuity investment fund shall be invested by the commissioner of revenue in investments authorized under AS 39.35.110. The commissioner of administration shall credit individual annuity accounts with earnings at a rate equal to the rate of interest earned by the annuity investment fund.

(d) The legislature may annually appropriate to the Department of Administration an amount sufficient to pay monthly annuity payments for the subsequent fiscal year under AS 37.16.030 from the annuity investment fund. Funds appropriated under this subsection shall be transferred from the annuity investment fund to the Department of Administration in order to meet the current demands of the annuity program.

(e) The legislature may annually appropriate from the annuity investment fund an amount sufficient to administer the annuity program. Any costs of administration funded under this subsection shall be equitably allocated among all individual annuity accounts.

(f) Notwithstanding AS 39.35.110 or (c) of this section, the commissioner of revenue may invest all or part of the annuity investment fund in commercial insurance contracts.

Sec. 37.16.020. ANNUITY PROGRAM. (a) The annuity program is administered by the commissioner of administration. The commissioner of administration shall adopt regulations necessary to implement the annuity program.

(b) The commissioner of administration shall maintain records of individual annuity accounts and make annuity payments under AS 37.16.030.

Sec. 37.16.030. PAYMENT OF ANNUITIES. (a) An individual with one or more annuity credits may receive an annuity upon reaching the age of 65.

(b) An annuity under this section is a monthly payment during the life of the annuitant. The amount of the monthly payment shall be based upon the principal and accrued interest in the person's annuity account and shall be paid in the form of a straight life annuity. The size of the annuity may not vary on account of sex.

(c) An individual need not be a resident of the state to be eligible to receive an annuity payment from his or her account.

(d) An annuity share may not be assigned, sold, or otherwise transferred from one individual to another. The right to receive an annuity under this section terminates upon the death of the person who is eligible for the annuity and does not pass to that person's estate.

(e) If a person dies prior to age 65, his account shall be equitably distributed among the annuity accounts of all individuals of the same age.

(f) An individual does not receive a vested property right in an annuity payment until that payment is made. Notwithstanding the provisions of this section, the state is not obligated to provide annuity payments for annuity credits granted under AS 43.23.005.

* Sec. 10. AS 43.23.095(6) is repealed and re-enacted to read:

(6) "permanent fund dividend" means a credit to an annuity account under AS 37.16, unless the individual is either exempt under AS 47.45.015(b) or elects cash under AS 47.23.005(d);

* Sec. 11. AS 47.45.010(a) is amended to read:

(a) A person who is 65 years of age or over, who resides in the state for at least one year immediately preceding application for a

longevity bonus under this chapter may apply to the commissioner of administration for qualification to receive a monthly bonus [OF \$250].

* Sec. 12. AS 47.45 is amended by adding a new section to read:

Sec. 47.45.015. AMOUNT OF BONUS. (a) Subject to (b) of this section, the monthly longevity bonus is equal to \$250, increased by three percent each year beginning in fiscal year 1987, minus the maximum possible annuity for a person 65 years of age under the annuity program (AS 43.23.110 -- 43.23.120), as determined by the commissioner of administration.

(b) A person who is 65 years of age or over prior to January 1, 1986 is exempt from the annuity program reduction established in (a) of this section.

* Sec. 13. AS 47.45.070 is amended to read:

Sec. 47.45.070. UNQUALIFIED PERSONS. An unqualified person is one who

(1) does not meet the age or residence requirements as provided for under this chapter;

(2) meets the age and residence requirements of this chapter but either is confined in a state or federal mental health institution or facility and is certified by the state as unable to manage personal affairs, or resides in a nursing home as that term is defined in AS 08.70.180(5); however, if that person, at the time of commitment or commencement of residence, provided the principal support of a spouse, the commissioner of administration may determine to pay the confined person's bonus to the person's spouse until the spouse is qualified for a bonus;

(3) is otherwise qualified but confined in a penal or correctional institution or facility; upon completion of sentence or upon the conferral of a pardon, parole or probation, the person may

make application; confinement outside the state shall be considered as residence in the state if a person was convicted and sentenced from a court in Alaska; revocation of parole or probation shall be cause for immediate disqualification until release from confinement is again effected;

(4) voluntarily leaves the state and remains absent from the state for a continuous period of more than 180 days.

* Sec. 14. Section 11, ch. 38, SLA 1984 is amended to read:

Sec. 11. Sections 7 and 9 of this [THIS] Act [AND AS 47.45] are repealed June 30, 1985.

* Sec. 15. AS 43.23.045(c) is repealed.

* Sec. 16. This Act applies only to permanent fund dividends for years beginning after December 31, 1985.

* Sec. 17. This Act takes effect January 1, 1986.

①

MAR 17 1983

THE LONGEVITY BONUS PROGRAM:
OPTIONS UNDER THE VEST SETTLEMENT

JON K. TILLINGHAST
Birch, Horton, Bittner, Pescinger & Anderson

March 8, 1983

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I. INTRODUCTION

On June 14, 1982, the United States Supreme Court ruled that the cumulative residency requirements of Alaska's permanent fund dividend distribution program violated the Equal Protection Clause of the United States Constitution.¹ Shortly thereafter, Alaska's Longevity Bonus ("ALB") Program was challenged on equal protection grounds.² On August 9, 1982, the Department of Law, with the approval of the Alaska Legislative Council, entered into a stipulation in the Vest case which stayed all proceedings pending adjournment of this legislative session, in order to afford the legislature an opportunity to address the constitutional problems with the existing program.

The purpose of this report is to analyze some 10 options available to the legislature in amending the Alaska Longevity Bonus Program. This report is a first step in a process which must be completed by the end of this session. As subparts (C) and (D) of this section discuss, the likely consequence of failing to enact remedial legislation this session is that the ALB program will be judicially terminated.

A. Description Of The Longevity Bonus Program

Predecessors of the existing ALB program can be traced to 1915. In that year, the Territorial Legislature authorized a monthly allowance of \$12.50 for needy elderly Alaskans of 10 years

¹Zobel v. Williams, 72 L. Ed. 2nd 672 (1982)

²Vest v. Shafer, 1 JU-82-1103 Civ. (1st Jud. Dist., 1982)

residency who chose not to enter the newly-created Pioneers' Homes.³ The current program was enacted in 1972⁴ as a result of legislation introduced by Senators Butrovich and Ray.⁵ Quite unlike the "need-based" focus of its predecessors, the 1972 legislation was to:

"... provide all law-abiding Alaskans capable of managing their own affairs who have maintained a domicile in the state for at least 25 years and have reached a retirement age of 65, an incentive to continue uninterrupted residency in the state. Under no circumstances shall this chapter be considered a form, type, or manner, of public relief. The bonuses made under this chapter are not predicated on need even though they may appear to provide supplemental income to some qualified persons who would otherwise be forced to become responsibilities of the state. The Legislature further finds and states that this legislation recognizes the economic hardships suffered by many elderly Alaskans, Alaskans who through their tenacity and perseverance molded Alaska as we know it through skillful application of their talents. These pioneers are the same Alaskans who, in the prime of their life, were in effect treated as second class citizens by the federal government and who paid much of their hard earned income to a government in which they did not have the right to participate through the power of the ballot. The legislature also is aware of the fact that many of these pioneers have been forced to live out their retirement years in areas far away from the land they loved and nurtured and thereby also suffering, in many cases, the loss of familial relationship with their own kin, an experience that is sad and frustrating to them as well as depriving new generations of Alaskans the benefit of their wisdom and experience. This legislation hopefully will provide our pioneers with the economic means to remain in and continue to serve their state and to enjoy the opportunity of aiding

³Chapter 64, SLA 1915.

⁴Chapter 205, SLA 1972; AS 47.45.010 et. seq.

⁵SB 211, 7th Leg., 2nd Sess.

the new Alaskan in making the state truly "The Great Land." §1, Ch. 205, SLA 1972.

The ALB program, then, has several purposes:

1. providing an incentive for a particular class of senior citizens to remain in the state;
2. compensating for the hardships faced by retirement in Alaska;
3. rewarding the past contributions of Alaska's elderly;
4. compensating for past hardships suffered by Alaska's pioneers; and
5. retaining the wisdom and experience of Alaska's pioneers.

Originally, the bonus was \$100 per month. Over the years, the amount has gradually increased to its current \$250 per month.⁶ A person is eligible for a bonus if he or she:

1. is 65 years of age or older;
2. was "domiciled in the territory" on or before January 3, 1959; and
3. has been continuously domiciled in the state for 25 years.⁷

Additionally, if a person is absent from the state for more than 30 days, he will not receive another bonus until he returns. AS 47.45.030. If the person is absent for a continuous period in excess of 180 days, he is ineligible for a bonus for the next 12 calendar months following his return. Id.

⁶Chapter 13, SLA 1981

⁷AS 47.45.010

Exceptions are made if the absence "is beyond the control of the recipient." id.

The Longevity bonus is taxable under the Internal Revenue Code. However, it is almost universally excluded in calculating income eligibility for state and federal assistance programs.⁸

8. The Individuals Covered By The Alaska Longevity Bonus Program.

There are currently some 9,425 Alaskans receiving some \$23.4 million in longevity bonus payments. Sketching an accurate portrait of the state's ALB recipients is difficult, because the ALB application form requires little personal information. In 1976, the Alaska Department of Health and Social Services conducted a random survey of ALB recipients,⁹ and, in conjunction with the Vest

⁸Under 42 U.S.C. §1382(a)(b)(2)(3), which governs eligibility for federal Supplemental Security Income, and by reference also controls other federal programs such as Medicaid and energy assistance, the following is excluded from the definition of income:

"monthly (or other periodic) payments received by any individual under a program established prior to July 1, 1973, if such payments are made by the State of which the individual receiving such payments is a resident, and if eligibility of any individual for such payments is not based on need and is based solely on attainment of age 65 and duration of residence in such state by such individual."

⁹"Alaska Longevity Bonus Impact Survey," Alaska Department of Health and Social Services (1976) (hereinafter "ALB Survey")

settlement, the Department of Law conducted a non-random survey of some 1,396 participants.

From those surveys, it is apparent that a large percentage of ALB recipients are Alaska Natives living in rural areas of the state.¹⁰ Moreover, and in large part because of the ineligibility of many rural residents for social security, the longevity bonus is often the primary source of income for rural residents. For example, 41% of the elderly in Southwest Alaska, and 66% in Northwest Alaska, rely on the longevity bonus as their primary source of income.¹¹

Available evidence suggests that a large percentage of ALB recipients have incomes only marginally above the current state welfare assistance level of \$546 per month. The Department of Law's 1982 survey -- which was skewed toward the more needy recipients of the ALB -- found that 81.4% of the 1,396 recipients sampled had monthly incomes of \$750 or less. The 1976 ALB survey found that half of the ALB recipients had a monthly income, "including that of their spouse," of under \$500 per month.¹² Another

¹⁰In 1976, 41% of the ALB recipients lived in rural areas of the state and 24.1% were Alaska Natives. ALB Survey at 14-15.

¹¹"An Assessment of the Status and Needs of Alaska's Elderly," Department of Sociology, College of Arts & Sciences, University of Alaska (1981) (hereinafter "Assessment.")

¹²ALB Survey, op. cit. n. 9 at 18-19.

44% had incomes of less than \$1,000 per month. A 1981 University of Alaska survey indicated that roughly half of Alaska's elderly had monthly incomes of less than \$300.00.¹³

The 1976 ALB survey suggests that, in light of the high percentage of bonus recipients in the 65-70 age group, the bonus has had a material effect in allowing older citizens to remain in the state after retirement.¹⁴ The report also indicates that the ALB program has allowed a significant percentage of the elderly to remain off various public assistance programs -- including food stamps and state Old Age Assistance.¹⁵

One significant characteristic of Alaska's elderly in general warrants note -- one that will become quite significant in our analysis of alternatives. Only 10% of Alaska's elderly have resided in the state for 10 years or less.¹⁶

C. The Effects of Zobel And Vest On The ALB Program.

In reviewing the 1972 legislation creating the Longevity Bonus Program, the Department of Law concluded that "... the classification predicated upon being domiciled in the territory on or before January 3, 1959, bears little, if any, rational relationship to any legitimate legislative purpose which this bill is conceivably designed to serve and thus is in

¹³Assessment, op. cit. n. 11 at 31.

¹⁴ALB Survey, op. cit. n. 9 at 12.

¹⁵Id. at 10, 13.

¹⁶Assessment, op. cit. n. 11 at 12.

all probability unconstitutional."¹⁷

Nonetheless, the ALB program remained unchallenged until 1932, following the U.S. Supreme Court's decision in Zobel v. Williams (hereafter "Zobel III").¹³

The law in issue in Zobel III (AS 43.23.010 et. seq.) provided for the distribution of a permanent fund dividend of \$50.00 for each year of accumulated Alaska residency. The Court ruled, 8-1, that the cumulative residency requirement of the program was not rationally related to the goals of the statute -- a ruling which is discussed in more detail in section II(A), post.

The permanent dividend fund distribution program, in part, was intended to reward Alaskans for prior contributions to the state, a goal which: (1) three justices believed was constitutionally impermissible;¹⁹ and (2) five justices believed was a permissible goal, but was not rationally furthered by a scheme

¹⁷Memorandum, Havelock to Egan, Re: FCCS HCS CSSB 211 at 17 (June 29, 1972).

¹⁸In Williams v. Zobel, 619 P.2d 422 (Alaska 1980) ("Zobel I"), the Alaska Supreme Court invalidated the state's graduated personal income tax repeal. In Williams v. Zobel, 619 P.2d 448 (Alaska 1980) ("Zobel II"), the court upheld the cumulative residency requirement of Alaska's permanent fund dividend distribution plan -- a ruling reversed by the U.S. Supreme Court in Zobel III.

¹⁹Opinion of the Court, 72 L. Ed. 2nd at 679.

which awarded dividends solely on the basis of residency.²⁰

Beyond the ruling of the case, the various opinions -- particularly those of the concurring justices -- are rich in forboding language suggesting that any durational residency requirement may receive "intensified scrutiny" by the Court, and will be justified only in "rare" circumstances.²¹

As is more fully discussed in Part II(A), post, the impact of the Zobel decision upon the ALB program was apparent. Two major goals of the existing ALB program are to reward elderly Alaskans for their prior contributions, and to compensate for past hardships and suffering -- ends which are implemented by a durational residency requirement more severe than that at issue in Zobel. A challenge to the ALB program was not long in coming. On July 6, 1982, one Rodney G. Vest challenged the ALB program in Superior Court in Juneau.²² Mr. Vest is an elderly Alaskan whose residency in the state commenced three months after statehood. His complaint sought declaratory and injunctive relief striking the durational and statenood residency requirements of the act.

The State's response was colored by §2 of the legislation, which provided, inter alia, that:

²⁰See Brennan conc., 72 L. Ed.2nd at 634; O'Connor conc., 72 L. Ed. 2nd at 635.

²¹Brennan conc., 72 L. Ed. 2nd at 631, 684.

²²See n. 2, ante.

"if any provision of this act, or the application of a provision of this act to any person or circumstance is held invalid, this entire act shall be considered invalid."

As the Department of Law explained in reviewing the 1972 law:

"It is clear that the intent of the Legislature expressed in Section 2 of the bill is to forestall the possibility that a partial declaration of unconstitutionality would result in broadening the coverage of the bill to include additional clauses. This would be the case, for example, if either the 25 year waiting period requirement or the January 3, 1959 cutoff date were declared invalid, and the bill was expressly or impliedly severable."²³

Thus, invalidation of the Longevity Bonus Program would result not in expanding the number of ALB recipients, but rather in the abrupt termination of the entire program.

Facing that grim probability, the State, with the approval of the Alaska Legislative Council, entered into an agreement with Vest, a copy of which is attached as Appendix A. The essence of the agreement is as follows:

1. Proceedings in the Vest case are stayed through the conclusion of this legislative session. Because that case has been subsequently certified as a class action,²⁴ existing ALB recipients are not in jeopardy at least through adjournment of this session;
2. The Alaska Legislative Council promised to use its "best efforts" to secure the enactment of legislation which treated equally "all persons 65 years or older as of July 1, 1982, who have been bona fide Alaska residents for at least one year prior to that date";

²³Op. cit. n. 17 at 5.

²⁴Order Certifying Class and Directing Notice to Class Members, Oct. 1, 1982.

3. If legislation of this sort were enacted this session, the suit would be dismissed; and

4. Recognizing that the Council could not bind the legislature, if legislation is not enacted, Mr. Vast may pursue his case, with the probable result that the program will be terminated.

There are three aspects of the settlement which warrant note. First, obviously, are the severe time constraints under which the legislature is operating. Second, there is the settlement's intentionally broad litmus test of acceptable legislation. All the legislature need do is treat all elderly, one-year Alaskan residents "equally." The standard could be met by any number of options, including repeal of the program. Third, there is the inescapable financial impact of the settlement itself. In order to treat all elderly Alaskans who were one-year residents as of July 1, 1982 equally, it will be necessary to fund retroactive longevity bonus payments under the existing program to the some 3,300 elderly Alaskans who would have qualified. The necessary retroactive appropriation is approximately \$11.4 million.

Of course, the legislature itself is not "bound" to pass any particular kind of legislation, or any legislation or appropriation at all. While a "best efforts" clause is enforceable, that obligation runs only to the Alaska Legislative Council, which has already demonstrated both good faith and diligence in attempting to meet the obligations of the order and settlement.