TESTIMONY ON SB 141
HOUSE FINANCE APRIL 23, 2005
TOM HARVEY, EXECUTIVE DIRECTOR, NEA-ALASKA

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

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

<u>DC PLAN TO REPLACE DB PLAN:</u>

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

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

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

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

<u>Mercer's Assumptions</u>	<u>Alaska's Experience</u>
Inflation will be 3.5%	2.6% over any ten year period, PF uses 3% and Gov. uses 3%
Wage Growth 3.75-4.5%	1.36%
Investment return 8.25%	9% over any ten-year period
Health Care Costs 12.5% - 5%	8% (7.5% according to Esuchanko)

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

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

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

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

<u>COMPOSITION OF A NEW BOARD:</u>

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

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

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

<u>POWERS AND DUTIES OF ARM BOARD:</u>

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

<u>EMPLOYER/EMPLOYEE CONTRIBUTION TO THE DEFINED BENEFITS PLANS:</u>

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

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

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

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

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

DEFINED CONTRIBUTION PLAN ELEMENTS:

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

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

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

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

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

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

Coupled with the HRA of 2% and the pension rate of 8.25% recommended above, the 3.75% medical contribution would yield a total employer's contribution rate of 14%, which is the actual amount the state and local government contributed at statehood.
Immediately after statehood, the cost share for public employees was spilt into about equal thirds; one-third from the State, one-third from the employer and one-third from the employee. When the State dropped their share (about 7% of salary) the promise was the State would increase revenue sharing to offset those costs. The State has deserted that commitment by no longer funding revenue sharing in the budget. Now the State proposes to shift its obligation to the employee. Instead of following the axiom that stuff flows downhill, the State should maintain the 14% original obligation. Remember this obligation was made before we had OIL!

It has been stated to House State Affairs that NEA-Alaska asked for a vesting period of five years. Let me correct the record, in testimony before the Senate Finance Committee we confirmed five years is a standard vesting period and we had no objection. We also pointed out that the five-year period coincided with the "five-year itch" that infects educational employees. The data is clear. We are losing 50% of new employees over the first five years. ***If an employee can now take their contribution and return home, portability is not a factor that benefits Alaska's schools. However, if you are going to implement a Defined Contribution (DC) Plan, then we suggest that you provide the same benefit that NEA-Alaska provides to its employees, immediate vesting.***

The investment method outlined in SB 141 is a standard approach for DC plans. Sen. Stedman has confirmed to NEA-Alaska that most national data demonstrates that an individual making investment decisions is more conservative than a group responsible for investing. In fact the difference is 1 to 3% annually. ***NEA-Alaska recommends that the investment responsibility be handled by ASPIB or the ARM Board.***

<u>TIMEFRAME:</u>

Mr. Chairman, I realize my time here is waning and there are so many other issues to touch on. I have addressed only the tip of the iceberg and have not even mentioned the mass of the iceberg which is containing medical costs/health insurance. This piece is estimated to be almost 70% of the unfunded liability problem. There have been many suggestions about how to contain these costs. I am confident that a "blended plan" with a major medical component that has built-in cost containment methods could be fashioned by all the stakeholders in six months.

I would like to go on record with a word of thanks for Sen. Stedman, Rep. Seaton and their staff. NEA-Alaska representatives have spent several hours with both legislators and their staff assigned to the PERS/TRS legislation. However, that time cannot serve as a substitution for meetings of all the stakeholders to provide a complete analysis of the legislation and its affect on public servants.

As we sit here on the 104th legislative day, I urge this committee to take the interim to truly study the retirement system and to make competitive changes in the retirement plan that affects over 70,000 Alaskans.

NEA-Alaska is fortunate to have many members that have served on the TRS board and understand retirement issues well. We look forward to working with all of you this summer and fall to design a plan that works for Alaska and Alaskan workers.

I appreciate your time and I would be happy to attempt to answer questions.