

MEMORANDUM



DATE: January 4, 2023
TO: Assembly Finance Committee
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SUBJECT: Deferred Compensation Retirement Plan Match Proposal

The Problem of Alaska PERS Tier IV

As CBJ struggles to recruit new employees and retain current employees, the PERS Tier IV retirement system remains a challenge. Most governments in the United States continue to offer a *defined benefit* pension system (similar to AKPERS Tiers I/II/III), and Alaska's *defined contribution* individual retirement account system (AKPERS Tier IV) is not competitive by comparison. With defined benefit plans, employers guarantee a specific pension benefit for each participant in the plan. By contrast, defined contribution plans establish an individual retirement savings account managed by the employee. Defined contribution plans shift the responsibility for investment decisions and the risk of market performance off the employer and on to the employee. Because Alaska PERS is a state-run program, CBJ has no ability to enhance the defined contribution retirement benefit currently offered, and generally no ability to opt into a different system altogether. Notably, the Tier I/II/III retirement system has the built-in retention incentive that the retirement benefit grows the longer an employee stays in the system and there are financial penalties for early separation. Conversely, for Tier IV employees, their entire accrued retirement benefit is entirely portable after five years of employment, which eliminates any incentive to remain employed by a PERS employer.

Proposing a Deferred Compensation Matching Provision

Acknowledging that Tier I/II/III employees already enjoy a substantially richer retirement benefit than Tier IV employees, and that Tier I/II/III employees are naturally incentivized to remain in the PERS system—CBJ management proposes to offer a monetary match to the deferred compensation contributions made *by Tier IV employees only*. CBJ already has a deferred compensation plan in place, operating under section 457 of the IRS tax code that offers employees the ability to defer a portion of their current income to when they separate from employment. Employees who actively contribute to a 457 retirement savings account can significantly enhance their ability to retire comfortably without fear of running out of retirement funds during their lifetime. A deferred compensation match for Tier IV employees would help to equalize the total benefit package between Tier I/II/III employees and Tier IV employees. (See end of this memo for a longer discussion of Tier IV vs. Tier I/II/III.) Since nearly all new applicants to CBJ will be in Tier IV, a deferred compensation match would assist with recruitment by enhancing CBJ employment offers relative to the State of Alaska, other local governments, and many private employers.

Proposed Match and Vesting Structure

CBJ management proposes an escalating match and vesting schedule based on employee longevity as follows:

Years of Service	Employee Contribution	Employer Match
0 – 2 years	2% voluntary	1% match
2 – 5 years	4% voluntary	2% match
5+ years	6% voluntary	3% match

Years of Service	Vesting
1 year	20%
2 years	40%
3 years	60%
4 years	80%
5+ years	100%

Such a matching benefit is estimated to cost CBJ \$550,000 annually (\$410,000 GF, \$140,000 other funds), assuming an average 2.5% match and 85% participation. This amount would grow in future years as salaries

increase and as Tier I/II/III employees are replaced by Tier IV employees through attrition. This amount includes CBJ general government and all enterprise functions *except Bartlett Regional Hospital*.

Mechanics of Plan Design

CBJ management has discussed the mechanics of such a matching program with MissionSquare Retirement (CBJ’s plan record-keeper) and HYAS Consulting (CBJ’s independent consultant). Their consensus recommendation is to structure the program such that the employer match portion is earned based on an employee’s 457 contribution but to deposit the employer match portion to a separate 401a account. Deferred compensation programs under IRS tax code section 401a are similar to 457 plans, but they have several distinct advantages for the purpose of an employer match. First, an employee’s ability to contribute individually to the allowable 457 maximum amount would not be diminished. Second, only a 401a account allows for a graduated vesting schedule. Third, contributions to a 401a do not induce the added expense of FICA payroll taxes.

Auto-Enrollment in CBJ’s Deferred Compensation Program

As a related concept, retirement professionals argue that auto-enrollment in the deferred compensation plan is in the best interest of most employees. There are convincing research findings that auto-enrollment into deferred compensation retirement plans yields better retirement outcomes for more retired employees. The benefit of auto-enrollment is so strong that the recently adopted federal SECURE Act 2.0 *requires* auto-enrollment for most employers and employees in non-governmental 401(k) and 403(b) retirement plans. This provision does not apply to government plans. With auto-enrollment, employees would automatically contribute a nominal amount to their deferred compensation accounts from the initiation of their employment. Employees who do not wish to contribute could simply opt-out. Under Alaska law, an employer may not implement auto-enrollment in a deferred compensation program without agreement from a collective bargaining unit. Accordingly, management intends to approach CBJ’s collective bargaining units to discuss Letters of Agreement that would allow auto-enrollment of bargaining unit members in CBJ’s 457 plan. Currently, there is no mechanism in Alaska law that would allow for auto-enrollment of non-represented employees.

Conclusion and Recommended Action

Auto-enrollment and an employer match are separate concepts with separate considerations, but in combination, the two are synergistic, substantially enhancing retirement security for employees while also improving recruitment and retention for CBJ as an employer.

CBJ leadership requests that the Assembly Finance Committee direct staff to develop a deferred compensation matching program, build the cost of such a program into the Manager’s Proposed FY24 Budget, and engage collective bargaining units in discussion of auto-enrollment.

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Further Explanation of the Employer Cost of PERS Tier IV vs Tiers I/II/III

In the context of the above proposals, it is worth taking some space here to explain the employer’s cost for Tier IV vs. Tiers I/II/III. Alaska’s defined benefit retirement system (Tiers I/II/III) has accrued a substantial *unfunded liability*—a gap between the accrued assets available to pay benefits and the accrued future liability of benefits owed to members. At its peak, Alaska’s [unfunded liability exceeded \\$7 billion dollars](#). When an unfunded liability exists, a retirement plan is required to make additional contributions in order to bring assets in line with liabilities over time. There are two rates that determine the amount of additional contributions necessary. First, the “normal rate” is the amount of contributions (as a % of wages) required to pay benefits *currently accruing*. Second, the “actuarial rate” is the amount of contributions required to pay benefits that have *already accrued*. In many years, the normal rate would be between 13% and 18% while the actuarial rate would approach or exceed 30%.

In 2006, the Alaska Legislature and Governor closed PERS Tier III and initiated PERS Tier IV in an effort to stop the unfunded liability from growing any larger. However, this action did nothing to pay off the unfunded liability

that existed at the time. In an effort to control the burden of the unfunded liability on municipal employers, the Alaska Legislature and Governor devised the 22% contribution cap. Under this provision of law, municipal employers pay 22% of all wages (all tiers) until the unfunded liability is extinguished. And the State of Alaska pays the difference between the actuarial rate and 22%. These additional state payments are referred to as “state payments on-behalf” of municipal employers.

Hence, today, CBJ pays 22% of wages for all PERS-eligible employees, irrespective of whether they are Tier I/II/III or Tier IV. This is obviously peculiar because the “true cost” of Tier I/II/III benefits is in the range of 25% to 30% of wages, while the “true cost” of Tier IV benefits is less than 13% of wages. When CBJ pays 22% of a Tier IV employee’s wages to the PERS system, at least 9% of that cost benefits Tier I/II/III employees, not the Tier IV employees whose wages induce the employer cost. This is admittedly challenging to explain, and it may merit more explanation and/or discussion in committee.