

**MINUTES**  
**SENATE FINANCE COMMITTEE**  
**February 19, 2004**  
**9:06 AM**

**TAPES**

SFC-04 # 14, Side A  
SFC 04 # 14, Side B  
SFC 04 # 15, Side A

**CALL TO ORDER**

Co-Chair Gary Wilken convened the meeting at approximately 9:06 AM.

**PRESENT**

Senator Lyda Green, Co-Chair  
Senator Gary Wilken, Co-Chair  
Senator Con Bunde, Vice Chair  
Senator Fred Dyson  
Senator Ben Stevens  
Senator Donny Olson

**Also Attending:** SENATOR GARY STEVENS; DIANE BARRANS, Executive Officer, Alaska Student Loan Corporation and Director, The Alaska Commission on Postsecondary Education; MELANIE MILLHORN, Director, Division of Retirement & Benefits, Department of Administration; ANSELM STAACK, Chief Financial Officer, Division of Retirement & Benefits, Department of Administration

**Attending via Teleconference:** From an Offnet Sites: KEN VASSAR, Bond Counsel, Alaska Student Loan Corporation; BOB REYNOLDS, Actuary, Mercer Human Resource Consulting-Actuary

**SUMMARY INFORMATION**

SB 277-STUDENT LOAN PROGRAMS

The bill heard testimony from the Alaska Student Loan Corporation. The bill reported from Committee.

PUBLIC EMPLOYEES RETIREMENT SYSTEM/TEACHERS' RETIREMENT SYSTEM PRESENTATION

The Committee heard a presentation from the Division of Retirement

and Benefits in regards to the Public Employees Retirement System and the Teachers' Retirement System. No action was taken.

SB 203-OFFICE OF ADMINISTRATIVE HEARINGS

The bill was scheduled but not heard.

SB 285-MEDICAL ASSISTANCE COVERAGE

The bill was scheduled but not heard.

#sb277

CS FOR SENATE BILL NO. 277(HES)

"An Act relating to the Alaska Commission on Postsecondary Education; relating to the Alaska Student Loan Corporation; relating to bonds of the corporation; relating to loan and grant programs of the commission; relating to an exemption from the State Procurement Code regarding certain contracts of the commission or corporation; making conforming changes; and providing for an effective date."

This was the second hearing for this bill in the Senate Finance Committee.

Co-Chair Wilken communicated that additional work is required on an amendment that was discussed during the February 17, 2004 hearing; and therefore, it would not be offered. It would be addressed in other committees' hearings as the bill progresses.

Senator B. Stevens shared the understanding that bonds associated with this legislation were recently issued.

DIANE BARRANS, Executive Officer, Alaska Student Loan Corporation and Executive Director, The Alaska Commission on Postsecondary Education, Department of Education and Early Development, explained, "that Phase One of the three-year return of capital plan" included the issuance of bonds, supported by Corporation "assets that were already free and clear from our existing indenture." Therefore, yesterday's bond issuance, which received a good financial rate, was not dependent on this legislation.

KEN VASSAR, Bond Counsel, Alaska Student Loan Corporation, testified via teleconference from an offnet site and concurred that existing regulations allowed the issuance of the bonds in question. This legislation would allow the Corporation to issue additional bonds.

Senator B. Stevens asked whether the \$75 million bond package that was just issued would accrue against the \$280 million designated in this bill.

Ms. Barrans affirmed.

Co-Chair Green moved to report the bill from Committee with individual recommendations and accompanying fiscal notes.

There being no objection, CS SB 277 (HES) was REPORTED from Committee with previous zero fiscal note #1 from the Department of Administration; previous zero fiscal note #2 from the Department of Community and Economic Development; and a new \$120,000 fiscal note, dated February 12, 2004 from the Department of Education and Early Development.

[NOTE: This bill was returned to the Senate Finance Committee for further consideration. An additional hearing was conducted on March 22, 2004.]

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Public Employees' Retirement System  
Teachers' Retirement System  
Presentation

Co-Chair Wilken noted that this presentation would further educate the Committee on "the serious issue" of funding the Public Employees' Retirement System (PERS) and the Teachers' Retirement System (TRS).

MELANIE MILLHORN, Director, Division of Retirement & Benefits, Department of Administration, noted that Anselm Staack a thirteen-year employee of the Division accompanied her. In addition, Bob Reynolds, who has been the Actuarial Consultant to the State for four years, would be participating via teleconference. His employer, Mercer Human Resource Consulting-Actuary, is the actuarial firm that has been assisting the State for twelve years.

Ms. Millhorn defined an actuary as a person who "makes assumptions based on data in order to calculate benefit costs by using assumptions to project costs into the future as compared to the assets and the earnings that it will pay for those liabilities." Due to the fact that "the costs and the earnings have some uncertainty associated with them," this process is annually reviewed "by the PERS/TRS Board for adjustments and modification."

Each year the Legislature receives an Actuarial Valuation report on PERS/TRS as well as the Judicial Retirements System and others. This report measures a plan's liabilities; assets; compares the assets to the liabilities; and thereby determines a funding ratio. It also determines the employers' annual contribution rate, which is referred to as the calculated rate. Approximately twenty-three actuarial assumptions support the PERS/TRS valuation report with the two most important assumptions being investment results and health care expenses.

Ms. Millhorn stated that today's presentation is recapped in a handout titled "State of Alaska Public Employees' Retirement System Teachers' Retirement System Presentation to the Alaska State Legislature 2004" [copy on file]. The two aforementioned assumptions would be the primary focus of this presentation; specifically in regards to how they affect the retirement systems funding ratios today. The actuarial assumptions are located in Section 2.3 of the most recent Valuation Report [copy not provided] which is dated June 30, 2002. That report is the basis for determining the FY 05 employer contribution rate.

Ms. Millhorn noted that the handout also includes a section titled "White Paper" which summarizes the actuarial assumptions. Its purpose is to provide Legislators, employers and any other interested party, information and answers to commonly asked questions about the Retirement System. The Comprehensive 2003 Annual Report [copy not provided] also depicts the actuarial assumptions. These reports are available on the Department's website.

Ms. Millhorn stated that this "high level overview" would focus on the funding status, the FY 04 through FY 06 summary, "the two primary drivers that influence the funding ratio for the PERS/TRS System," which are the increase in health care costs and the loss of investment earnings, a review of the Employer FY 01 through FY 05 contribution rates, and the Employer contribution savings that occurred between FY 98 and FY 04.

Ms. Millhorn directed the Committee to the "System Funding Goals" which have been adopted by the PERS/TRS Board, as depicted on page 13 in the "White Paper" section of the handout.

#### System Funding Goals

The following are proposed system funding goals based on observed board discussions:

- Relatively stable contribution rates over time
- Actuarial funding of retire medical benefits

- 100% (102% for PERS) funded ratio of assets to accrued liabilities (including retiree medical)
- Pay for benefits during working lifetime (25 year period)

Senator Bunde asked the reason the PERS funded ratio is more than 100 percent.

ANSELM STAACK, Chief Financial Officer, Division of Retirement & Benefits, Department of Administration, explained that when the target is for 100-percent funding, "mathematically you don't quite ever get there." Therefore, the PERS Board designated 102-percent as the goal with the anticipation that 100 percent would be achieved.

Senator Bunde asked why the TRS Board did not mirror this approach.

Mr. Staack responded that the goals differ due to the fact that different boards are involved.

BOB REYNOLDS, Actuarial Consultant, Mercer Human Resource Consulting-Actuary, testified via teleconference from an offnet site in Seattle Washington and agreed that one of the reasons the percentage goals differ is that two different boards are involved. When a goal is determined, the end result is either higher half of the time or lower half of the time than the specified goal. The PERS Board acted a bit more conservatively than the TRS Board.

Senator Bunde asked whether this percentage goal difference is the reason that the PERS deficit is larger than that of TRS.

Mr. Reynolds responded that the PERS deficit is larger because, in absolute dollars, the liability to the system is larger. At the last valuation, the TRS system had approximately five billion dollars in liabilities and less than four billion dollars in assets whereas PERS had about \$8.5 billion in liabilities and six billion dollars in assets. Rather than being the result of the 102 percent funded ratio, the unfunded liability for PERS is greater due to the fact that it has a larger asset and liability base.

Senator Bunde asked whether reducing the PERS funded ratio to less than 100 percent would affect this deficit.

Mr. Reynolds responded that lowering the funded ratio to less than 100 percent would serve to reduce the deficit, as at 102 percent, the liability has been loaded by two percent. Therefore, were the percentage lowered to 100 percent the liability would be two percent lower. Subsequently, a lower unfunded amount would result. In summary, the two percent difference has a modest effect in

relationship to the effect generated by the larger asset and liability base.

Ms. Million directed the Committee to "Current Issues and Challenges" on page 15 of the White Paper section.

Current Issues and Challenges

Rising employer contribution levels and deteriorating funded status

- Primary reason:
  - financial market performance
  - rising cost of medical care

Ms. Millhorn then referenced the section in the booklet titled "Funding Status FY 04-FY 06 and explained that the document portrays the Earnings, the Actuarial Rate, the Health Care Costs, the Employer Rates, and the Funding Ratios for the Mercer Valuation Reports, dated June 30, FY 01, FY 02, and FY 03. These reports, respectfully, are used by the Board to determine the Employer Contribution Rate for FY 04, FY 05 and FY 06.

Ms. Millhorn pointed out that, as reflected on the document, the PERS Actual Investment Return for FY 01/FY 04 was a negative 5.25 percent with an Actuarial Assumption that assumes that the system would earn an Investment Return of 8.25 percent. The returns for FY 02/FY 05 reflect an Actual Investment Return of negative 5.48 percent with an Actuarial Investment assumption of 8.25 percent. FY 03/FY 06 reflect an Actual Investment Return of 3.67 percent with an Actuarial Investment assumption of 8.25 percent.

Senator Bunde noted that as a result of the downward stock market trend, private individuals would have shifted their 401-K investment portfolios from stocks to bonds "some time ago." Therefore, he questioned the reason the System continues to predict an 8.25 return when the market has reflected a three-year downward trend. At what point, would "actuarial adjustments be made that would reflect reality."

Mr. Staack explained that eight-percent would be the middle rate of fifty percent of the long-term earnings in the United States, long-term meaning a thirty-year period. The Board is willing to exceed this average, as historically the earnings of the Pension and Investment Board have exceeded market performance. The Actuarial Assumed Rate is key to the funding level of the entire plan as it is being utilized to amortize the entirety of the liabilities. Therefore, a decrease in the funded rate would serve to increase the unfunded balance. Were the Actuarial Investment Return rate of 8.25 percent lowered to seven percent, the increase in liabilities

"would significantly increase and the plan would be more under-funded." In conclusion, the 8.25 investment return rate is a proven rate that has been substantiated over a 30-year period.

Senator Bunde acknowledged that, over the long term this rate might be proven; however, he asked in regard to the short-term effect on the system.

Mr. Staack communicated that the Division has implemented a system in which allocated gains or losses are limited to 20 percent in any one year. This has a smoothing out effect. It must be viewed as a long-term process. Even though FY 02/FY 05, for example, had a total funding ratio of 75-percent and an Employer average calculated rate of 24-percent, the Board adopted a rate of 11.77 percent. It must be recognized that this is "many year process" rather than being limited to a single year process.

Senator Bunde countered therefore, that it could be argued that there is no deficit, as if "we wait long enough, it will catch up."

Mr. Staack agreed that argument could be made; however, he qualified that the plan must be funded "in between." Were some of those losses not recouped and were contributions to continue into the plan, the period in which the plan could be balanced would be expanded. 75-percent of any retirement system's plan are from investment earnings with only 25-percent balance being derived from employer/employee contributions. Some of those gaps must be filled with calculated contributions overtime because, were they not, the deficit time period would be lengthened.

Mr. Reynolds acknowledged that another issue is that while each Actuarial Valuation is based on best estimate assumptions, a long-term trend could change long term funding assumptions. These trends include such things as longevity, lower mortality rates over the last ten to 20 years due to medical advancements, and higher medical expenses. These trends serve to increase the liability of the system, and therefore, over time, the assumptions must be adjusted. A higher funding target would require a rate adjustment. Were long term trends to continue unchanged, there would not be a need to react to changes in the plan's funding status as the philosophy could be that things would sort themselves out over time.

Senator Bunde asked whether poor market returns in the past have required "a general fund infusion" into the PERS/TRS systems.

Mr. Staack responded that the money that is contributed to the systems results from the Employer rate contributions. Therefore,

due to the fact that the State is an employer, the general fund has continuously been utilized in that manner. The general fund has never been utilized for any extra infusion of funding beyond the Employer contribution rate.

Senator Bunde understood that due to market fluctuations, a contribution above the Employer contribution rate might be required.

Mr. Staack clarified that, other than the increase resulting from a rise in the Employer calculated rate, no additional general fund contribution was sought. Any additional monies that would be required would result from an increase in the Employer contribution rate.

Senator Bunde acknowledged, but commented that any increase in the Employer contribution would affect the general fund. In reality, the \$76 million shortfall would be supported by the general fund.

Mr. Staack responded that in some form it would be, as 59 percent of any State expenditure is derived from the general fund with approximately 41 percent being derived from other funding sources such as federal funding.

Senator Bunde understood therefore that approximately 40 percent of the \$76 million PERS deficit would be funded from sources other than the State.

Mr. Staack concurred.

Senator B. Stevens understood that, as depicted on the document, the "Non-Medical Benefits only" PERS Funding Ratio-Assets\Liabilities component was 143.7 percent over-funded in FY 01/ FY 04.

Ms. Millhorn replied that is correct were only the pension portion considered and the medical cost component removed.

Senator B. Stevens continued that in FY 02/FY 05, there would be a 24.8 percent cumulative funding deficit; however, the Non-Medical Benefits only component is over-funded by 120.9 percent.

Ms. Millhorn agreed.

Mr. Staack pointed out that were the health costs included, the funding level would be the "Total benefits" as depicted.

Senator B. Stevens asked the definitions of "Non-Medical Benefits

only" and "Total Benefits".

Mr. Staack defined "Total Benefits" as being the total liability for the system's monthly pensions and health care costs. The reason this breakout is provided is due to the fact that Alaska is one of the few governmental entities in the country that actuarially funds health care costs. California, Texas, and other states do not. It is difficult to compare the State's program to others and were another state to declare that its retirement system was 95-percent funded; one must compare that claim to the Alaska's "Non-Medical Benefits only" component. The State of Alaska would be obligated to pay the Total Benefits component, which includes both monthly pensions and health care.

Senator B. Stevens understood that while the State has a cash obligation to the pension portion, the deficit must result from medical costs as the pension portion is fully funded. Therefore, he asked how the medical component dollar value obligation is determined.

Mr. Reynolds responded that the principle at play in this regard is the determination that the benefit amount that would be anticipated for an individual's lifetime is based on calculations such as when that person would retire and the pension and medical benefits that that person would receive. Once this is determined, such things as the longevity assumption and medical cost increases would be applied. An individual's total cost, or "accrued liability" would be calculated and would be the amount the State would be obligated to fund. The idea is that adjustments must be made against these measurements in order to support them over time. As the retirement components are in regulation and could not be adjusted downward, any required infusion of supporting funding must be funded via alterations in the Employer Contribution funding rate.

Senator B. Stevens commented that the fact that the Non-Medical Benefits-only funding has been maintained at 120 percent even after recent financial market downturns indicates that the component has been well managed. However, when the total benefits are considered, there appears to be a problem in the manner it is being funded. Furthermore, it appears that this is an issue that rather being solved by a one time monetary "injection" would continue due to the escalating costs of health care and longer life spans that would accrue more medical costs. This is a problem that would not be going away.

Ms. Millhorn stated that the State's plan is "atypical" and "quite generous on the medical side."

Senator Dyson asked whether, in the historical sense, changes in the employer and employee contribution have any affect on behavior. In other words, would employees take better care of their health to avoid being required to contribute more or would employers change the manner in which they treat employees in regards to such things as a later retirement age.

Ms. Millhorn characterized the situation "as a two-edged sword" as while improvements in the medical field have increased life spans there has, on a national basis, been a 13-percent increase in the cost of health care. In regards to active employees, the State could implement a variety of options. Requiring employees to pay more of their health care costs would not necessarily result in employees making good health care decisions. A Board has been established that is addressing cost containment issues relating to the retiree population. She noted that the Retired Public Employees Association brought a lawsuit before the State Supreme Court, regarding the fact that some Legislative changes were made that, while reducing some retirement benefits, did not result in a corresponding increase in cost savings. The Court decision in June 2003 stated that changes could not be made to the retiree health care component unless it could be demonstrated that the corresponding decreases for the 27,000-retiree population and their dependents, both of which would total approximately 54,000, has a corresponding offset. An appeal is pending before the Superior Court.

Senator Dyson concluded therefore that changes would be limited by Court decisions and employee contracts. Therefore, echoing Senator B. Stevens's comments, he inquired as to what types of structural changes might be available to address costs in the long run.

Senator B. Stevens pointed out that, as reflected in the "Employer Savings FY 98-FY 04" section of the handout, the PERS contribution rate has decreased from 12.14 percent in 1998 to 6.7 percent in 2003. "How can the Board justify a decrease of that amount" while health care expenses have annually increased by approximately 14 percent.

Ms. Millhorn responded that for a period of time the costs of health care were quite volatile in that they increased from 50 percent in one year to 30 percent to zero percent in other years. However, health care trend costs have been revisited in recognition of the fact that health care costs would continue to increase.

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Ms. Millhorn specified that the health care cost factor would be increased from 7.5 percent to 12 percent for the next five years. Costs are projected to taper off thereafter.

Senator B. Stevens reiterated that the question is why has the Board allowed the Employer Contribution to decrease from 12-percent in 1998 to 6.7 percent in FY 04 in light of the fact that the cost of medical expenses has escalated.

Mr. Staack pointed out that there is a two-year lag time between the rate being established by the Board and when it is implemented. He stated that the decision to lower the employer rate was based upon a combination of factors including the fact that, in addition to high medical expenses and a high employer contribution, a "tremendous amount of earnings" occurred between 1996 and the year 2000. Those earnings served to "dramatically" offset the liabilities. The Board's decision to lower the employer contribution rate was based on those elements. Now that the trend of upward medical expenses has been established, the Board's decision is to increase the Employer Contribution level.

Mr. Staack informed that TRS is a cost-sharing system whereas PERS is a multi-employer system in which there is an overall employer rate and a specific past service cost that accompanies each employer. Therefore the Municipality of Anchorage, the Fairbanks North Slope Borough and the State have differing rates. The TRS Board has continually adopted an average rate that is the same amongst all employers. The Bethel School District pays the same rate as the Municipality of Anchorage School District. Therein lies the reason that the rates differ.

Mr. Staack stated that as a result of the reduced Employer Contribution rate obligations that occurred during the years 1998 through 2004, \$460 million in associated employer contribution expenses were saved by municipalities as well as by the State.

Senator B. Stevens acknowledged this fact, however, argued that these same entities would now be shouldering the burden of the deficits that have occurred.

Mr. Staack informed the Committee that rather than actually saving \$460 million, municipalities and the State actually saved \$300 million because they experienced increases in other costs due to such things as an increased numbers of employees.

Senator B. Stevens viewed that as being the result of individual entities' decisions.

SENATOR GARY STEVENS asked regarding the comment that 75 percent of retirement earnings are gleaned from investment earnings. Specifically whether the State could increase current employees' contribution requirements in order to offset benefits paid to those who are fully retired or whether current employees' contributions could be increased to offset future retiree benefit obligations.

Mr. Staack replied that this involves a long-term process with the theory being that the contribution level should recover, over a person's working life, all the costs associated with providing benefits to that person. However, in a matter of eight years, the average amount of monthly health retirement benefit has increased from \$350.50 per retiree in 1996 to \$806 in 2004. As this money was not recovered during the retiree's working life, the money to cover past service costs must come from somewhere. All of the "past service costs" have significantly increased as exemplified by the fact that between the years 1983 to 1994, life expectancy has increased by 2.7 years and therefore, more than two years of retirement benefits have been added for the average retiree. While the new rate absorbs those 2.7 years, previous retiree benefits expenses were factored upon the lower mortality table. The money to pay for the extended years must come from the employers in the system, employees, and the investment earnings. It must be accepted that in a defined benefit plan system "the employer takes the risk of lower than expected investment earnings and higher than expected costs." This is further explained in the White Page section of the handout.

Senator G. Stevens asked whether the past service expense details are included in the handout.

Ms. Millhorn replied that this information could be found in the PERS Supplemental Actuarial Valuation report [copy not provided] for each employer.

Mr. Reynolds commented that while the actuarial assumptions are made by utilizing the best appropriate data and projections, were the assumptions too optimistic and the costs of the plan in the future to be under-estimated, the liability would be passed on to future generations. However, "were the assumptions set too conservatively," it would, in essence, place the burden of future workforce liabilities on the current workforce. It is difficult to walk that "thin line between being too optimistic and too conservative." There have been trends, longevity and medical costs in particular, for which the current workforce is paying for prior retiree benefit costs. The fluctuating medical costs, as aforementioned, made that projection difficult for certain periods of years.

Senator Olson asked how fluctuations and other increased expenses were addressed in the past.

Ms. Millhorn stated that the employer contribution rate has historically been "incrementally adjusted" to provide the required funding ratio.

Mr. Reynolds noted that the current PERS funding ratio is 75 percent and in 1980 the funding ratio was 71 percent. Once during this time period, the rate was 106 percent. The current funding ratio for the TRS system is 68 percent and was 67 percent in 1980. There have been periods of time in which the funding ratio has been lower than it is now. There is the requirement that the ratio be adjusted to reflect trends as they occur.

Senator Bunde, noting that the Employer Contribution Rate has been adjusted over time in response to system needs, stated that this is contrary to testimony that making such changes takes too long.

Mr. Staack agreed that while the rates have been changed, there remains a lag time between when the rates are set and when they are implemented. This is an issue. If the rates go up, it would require more money from employers. There is no special injection of money. The fund must sustain itself over time.

Senator Bunde stated that "the practical reality" is that, as rates increase, the Anchorage School District, for example, would request a one-time infusion to offset the expense. This is of concern, and he wondered whether assurances could be provided that this deficit would not re-occur.

Mr. Staack replied that no assurance could be provided.

Ms. Millhorn stated that Mercer Consulting would be presenting its June 30, 2003 Actuarial Valuation at upcoming PERS/TRS Board meetings. The Boards, at that time, would review the report and the assumptions and determine the Employer Contribution Rate for FY 06.

Ms. Millhorn informed that, by regulation, the PERS Employer Contribution Rate could only be increased or decreased up to a maximum of five percent. There is no limitation on TRS rate increases or decreases. Historically, the TRS Board has addressed this rate in a conservative manner and has "even adopted a higher rate to keep the contribution rate stable even though the recommendation by Mercer would be lower." The TRS Board has adopted a rate up to four percent higher than the recommended rate.

Co-Chair Wilken stated that this information is depicted in the third column of the spreadsheet in the "Funding Status FY 04-FY 06" section of the handout.

Ms. Millhorn affirmed.

Co-Chair Green asked for further information regarding the five-percent variance limitation.

Ms. Millhorn replied that the five-percent limit is specified in a regulation based on Statute.

Co-Chair Green asked for further information in this regard.

Ms. Millhorn specified that the regulation specifies that the Employer Contribution Rate could be increased up to five-percent or decreased up to five-percent.

Co-Chair Green understood therefore, that the five percent is specified in Statute. She stated that she would further investigate this limit.

Senator Bunde asked in regards to employee contributions.

Ms. Millhorn responded that the employee contribution could be addressed via the establishment of a new tier.

Senator Bunde opined that while there is a need for greater contributions, no current employee could be subject to an increased contribution rate. A new employee tier level would be required in order to consider altering the current employee contribution rate.

Mr. Staack stated that the Alaska Supreme Court has specifically addressed this issue. A court case involving the lowering of retirement benefits was argued in 1981 with the ruling being that the State could not diminish employee benefits. New hires benefits could be altered. This would require a new tier to be developed. Benefits could not be diminished for employees who retired or were hired prior to the enactment of the new tier.

Senator Bunde concluded therefore that once a contractual agreement is in affect, the terms could not be altered.

Mr. Staack stated that the interpretation is that increasing a current employee's contribution, would, "in a manner, decrease the benefit."

Senator Dyson asked whether the Court decision would prohibit an

employee from opting to voluntarily agree to make less of a contribution and receive "less benefits in the future."

Mr. Staack was uncertain of the answer.

Ms. Millhorn specified that while the TRS system is a cost sharing, multiple employer plan with a single uniform employer rate, there are 57 different PERS Employer Contribution Rates. She reviewed the TRS system Earnings, Actuarial Rate, Health Cost, Employer Rates, and Funding ratios as depicted in the "Funding Status FY 04-FY 06" section of the handout.

Ms. Millhorn reiterated that the TRS system does not have an annual percentage increase or decrease limit regarding its Employer Contribution Rate change. While the TRS Board could recommend a rate, the final authority is the Commissioner of the Department of Administration.

Ms. Millhorn noted that the next section in the handout, tabbed "Employer Savings FY 98-FY 04," individually depicts the increase that would be experienced by each of the 57 employers. The third page of that section identifies each of the TRS employers and the affect of the four percent increase they would experience. The fourth page of the section specifies that the total cost to PERS/TRS employers would be \$100 million dollars in FY 05.

Mr. Staack communicated that, were School Districts to relay information that their PERS contributions would amount to \$35 million, it should be noted that this amount includes both their TRS and PERS contributions.

Co-Chair Wilken asked whether a breakout of school districts' PERS and TRS employers' obligations could be provided.

Ms. Millhorn noted that in addition to the TRS breakout for school districts, their PERS obligations are incorporated into the PERS breakout in the section.

Co-Chair Wilken asked that a document be developed that solely reflects both the TRS/PERS obligations of the school districts.

Senator B. Stevens provided this information is a handout titled "ALASKA DEPARTMENT OF EDUCATION AND EARLY DEVELOPMENT" [copy on file], dated February 10, 2004.

Senator B. Stevens calculated that, of the \$100 million total PERS/TRS FY 05 expenses, \$38 million would be the State's PERS obligation, \$35 million would be the school districts' obligation,

and the balance of \$27 million would be the responsibility of municipalities and the University of Alaska.

Mr. Staack concurred.

Co-Chair Wilken observed that the University would be obligated for \$5.6 million in PERS and \$1.6 TRS expenses.

Senator B. Stevens asked that the Department provide the Committee a breakout depicting the PERS/TRS expenses associated for State employees, school district employees, University employees, and municipality employees.

Mr. Staack stated that of the \$100 million, \$38 million would be the State's PERS obligation; \$35 million would be school districts' TRS/PERS obligations; seven million dollars would be the University's PERS/TRS obligation; and \$20 million would be municipalities' PERS obligations.

Senator B. Stevens asked that this information be provided in document form.

Co-Chair Green asked that the information for the school districts and the University be further divided to reflect their PERS and TRS obligations.

Ms. Millhorn agreed.

Ms. Millhorn referred the Committee to page 23, titled "Retiree Medical Insurance" of the section titled "Medical Costs." As depicted, the monthly premium per retiree for health coverage in 1977 was \$34.75. The third column on the page depicts the annual year-to-year percentage changes and reflects the volatility experienced. "The annualized average increase is 10 percent." Today, the monthly premium for health coverage is \$806 per individual who is in the plan.

In response to a comment from Senator B. Stevens, Ms. Millhorn reiterated that the current premium is \$806 per individual per month.

Senator G. Stevens asked whether this includes the employee's dependents.

Ms. Millhorn affirmed.

Senator B. Stevens surmised therefore that \$806 is the whole liability for the member.

Ms. Millhorn replied that it is correct.

Ms. Millhorn pointed out that the next section in the handout titled "PERS Employer Rates FY 01-FY 05" reflects a five-year review of the changes in the Employer Contribution Rates that have resulted from the gains and losses in accrued liabilities. It depicts the "differences between the assumed experience and the actual experience." As depicted in the chart, the Beginning Average Employer Contribution Rate in 1997 was 7.36 percent; the Mercer Human Resource Consulting-Actuary recommendation, as reflected in the "Ending Average Employer Contribution Rate" was 7.03 percent; and the Board adopted an Employer Contribution Rate of 7.40 percent for FY 01. This information is specified for each of the years 1999 through 2002. It should be noted that in the years 1998 through 2000, the Board recommended a slightly higher rate than recommended by Mercer. The adopted rate in 2001, which would become effective in FY 04, was the rate recommended by Mercer. The information above the Employer Contribution Rate section depicts the assets versus liabilities changes that affected the annual employer contribution rates.

Ms. Millhorn stated that the next page, titled "PERS Summary of Benefits" reflects the various payment obligations from the PERS System. The total payments for the year 2003 amounted to \$451,015,000. The total payment in 1994 was \$157,913,000. This reflects the increase in obligations that have occurred. The medical component in 1994 was \$36 million and was \$143 million in the year 2003.

Ms. Millhorn noted that the next tab titled "TRS Employer Rates FY 01 - FY 05" reflects information pertinent to the TRS system. As depicted in the chart, the Beginning Average Employer Contribution Rate in 1997 was 13.0 percent; the Mercer Human Resource Consulting-Actuary recommendation, as reflected in the "Ending Average Employer Contribution Rate" was 10.55 percent; and the Board adopted an Employer Contribution Rate of 12.0 percent for FY 01. The TRS Board strives to have an Employer Contribution Rate that is "consistent over time" as reflected in its decision to adopt, in 1999, an 11 percent rate rather than the 7.09 rate recommended by Mercer for FY 02.

Ms. Millhorn noted that the information on page 28 of that section reflects the total TRS payment obligation. In 1994, the total benefits paid were \$116 million and the total paid in 2003 was \$310 million. The total 2003 PERS/TRS payment obligation is a large amount.

Ms. Millhorn stated that the information located in the tab titled "PERS/TRS Tier IV - Tier III Subcommittee" describes the Boards' task to develop Tier re-design recommendations for the future, as initiated by the Department of Administration Commissioner Mike Miller. The first meeting recently occurred and was attended by the Boards' members, the Commissioner, and Mr. Reynolds from Mercer. The committee would be requesting input from the 154 PERS/TRS employers in the State by way of a survey that is currently in draft form. She noted that there are many considerations including competing interests such as cost containments as compared to a benefit amount. A compromise must be developed that would balance those interests. The PERS/TRS Tier Subcommittee consists of Board members Bob Boko, Alyce Hanley, Richard Solie, and Frank Narusch. A draft

Ms. Millhorn stated that the final section in the handbook is titled "Comparison of Other Systems Funding Health Care." This section provides a comparison of Alaska's retirement system to 123 other government plans. Of those 123 plans, only eight pre-fund the health care portion of their retirement pension plans.

Co-Chair Wilken asked the purpose of sending the survey to PERS/TRS employers in the State.

Ms. Millhorn responded that it is necessary to obtain feedback from the PERS/TRS employers for when reviewing a retirement system and determining methods to contain costs, it must be recognized that the options might negatively affect the recruitment and retention of employees.

Senator B. Stevens asked for confirmation that only eight of the 123 government entities included in the Public Fund Survey pre-fund their medical expenses.

Ms. Millhorn stated that is correct.

Senator B. Stevens asked whether the chart reflected deficits and liabilities experienced by those eight in comparison to the others.

Ms. Millhorn stated that the chart does reflect funding ratios.

Senator B. Stevens understood that the asterisked entities are those that pre-fund their medical expenses.

Ms. Millhorn affirmed.

Senator B. Stevens noted therefore, that "Kentucky Teachers," which is one of the eight, has an Actuarial Funding Ratio of 86.6 percent

for its Actuarial Validation Report, dated June 30, 2002.

Ms. Millhorn affirmed. She stated that Alaska's PERS funding ratio as reflected in the June 30, 2001 Actuarial Valuation Report reflects a total benefits funding ratio of 100.9 percent for FY 04. The purpose of the information is to allow the State to compare its PERS/TRS programs to others with similar components.

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Mr. Staack stated that, "the accounting profession has never really helped this issue very much." Most retirement systems only include "the costs and the liabilities of their current year expenses" when determining health care expenses the next year. Most states do not provide "as generous a plan" as this State provides. However, by the year 2006, all governmental retirement systems would be required to include on their financial statements "the liability for all the unfunded health care that they haven't funded up until now." Alaska has done this for the last thirty years. Some of the other states would be surprised when this information is compiled. He reiterated that the information is to allow proper comparisons.

Co-Chair Green asked for clarification as to whether the new accounting measures would require pre-funding information to be displayed.

Mr. Staack stated that it would not. What it would require is that health care liabilities be reported on the financial statements. Until then, states such as California only reflect the cost of the next year's PERS/TRS health care obligations on their financial statements rather than their true liability.

Co-Chair Green asked whether Alaska's pre-funding mechanism is established in law.

Mr. Staack responded that the applicable statute is broad in that it allows the Board "wide latitude" in that they could establish the actuarial assumptions.

Co-Chair Green understood therefore that the pre-funding mechanism is Board directed.

Mr. Reynolds avowed that the Statute does require the system to be actuarially funded. To his knowledge, "it does not distinguish between the pension benefits and the medical benefits." Therefore, "the Statute does contemplate pre-funding of both benefits ... in a

pay as you go approach to the medical benefits." "Actuarial funding does mean pre-funding." Therefore there is both Statutory and regulatory requirements that would require this scenario for both medical and pension benefits.

Mr. Staack stated that were the actual liability not pre-funded, "that liability would be pushed on to future generations."

Mr. Reynolds concurred.

Co-Chair Green understood however, that currently the only entity which could undergo a rate adjustment to address liabilities would be the employer, as employees' rates could not be altered unless a new tier were established.

Mr. Staack affirmed.

Co-Chair Green asked whether any consideration has been provided to making statutory changes.

Ms. Millhorn responded that all avenues are being considered in the Tier re-design endeavor.

Co-Chair Wilken asked for confirmation that this is part of the task assigned to the Commissioner's subcommittee.

Ms. Millhorn affirmed.

Senator B. Stevens commented that were a new tier established that would include a defined contribution plan, the future employees in the new tier might be responsible for the escalating costs of the older tiers.

Mr. Staack clarified that in a Defined Contribution Plan, the employer would continue to bears the increased costs associated with retired employees. Were a new Defined Benefit tier to be established, funding from retirees would remain unobtainable even were costs increasing. Therefore, "the only party you can go to" is the employer.

Senator B. Stevens interjected "or the general fund."

Co-Chair Wilken asked the minimal amount that the Legislature could allocate to address the deficit resulting from this situation. Two things that might reduce the "\$100 million cash requirement" would include either recalculating the formula by basing the calculation on current data such as the FY 03 actuarial report and hoping for the continued healing of the stock market or consideration of

providing, for instance, \$50 million contribution towards the PERS/TERS obligation as a gesture of healing. In other words, is there anything that could be done to lower the rate increase below the five-percent scheduled for FY 05.

Mr. Staack stated that the Valuation Report that would be presented at a March 24, 2004 would serve to update the information. It indicates that the State is already experiencing a 34 percent earnings deficit for PERS. He expected that no reduction in the rate could occur even were updated reports provided.

Mr. Reynolds agreed that the Valuation Report that would be presented in March would be based on June 30, 2003 information and it would not provide for a significant rate improvement as the investment performance returns were approximately four percent rather than the 8.25 percent assumption. The updated Valuation is anticipated to recommend a higher Employer Contribution rate. Mercer does conduct future projections in regards to what the rates might allow. Therefore the influence of more recent market upturns would be provided to the Boards during the upcoming March meeting.

Co-Chair Wilken asked whether the five-percent increase in Employer rates is a firm obligation.

Mr. Staack understood that this obligation would continue.

Co-Chair Wilken voiced that this presentation was very informative.  
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#### **ADJOURNMENT**

Co-Chair Gary Wilken adjourned the meeting at 10:55 AM