

HOUSE FINANCE COMMITTEE
January 19, 2005
1:34 p.m.

CALL TO ORDER

Co-Chair Meyer called the House Finance Committee meeting to order at 1:34:25 PM.

MEMBERS PRESENT

Representative Mike Chenault, Co-Chair
Representative Kevin Meyer, Co-Chair
Representative Bill Stoltze, Vice-Chair
Representative Eric Croft
Representative Richard Foster
Representative Mike Hawker
Representative Jim Holm
Representative Reggie Joule
Representative Mike Kelly
Representative Bruce Weyhrauch

MEMBERS ABSENT

Representative Carl Moses

ALSO PRESENT

Representative David Guttenberg, Representative Peggy Wilson, Representative Paul Seaton, Representative Mark Neuman, Melanie Millhorn, Director, Division of Retirement and Benefits, Department of Administration; Kevin Brooks, Deputy Commissioner, Department of Administration; Ray Matiashowski, Commissioner, Department of Administration; Louanne Christian, Committee Assistant, House Finance Committee.

PRESENT VIA TELECONFERENCE

Robert Reynolds, Actuarial Consultant, Mercer Human Resource Consulting; Bob Reynolds, Mercer Human Resource Consulting

GENERAL SUBJECT(S):

OVERVIEW - PERS AND TERS

The following overview was taken in log note format. Tapes and handouts will be on file with the House Finance Committee through the 24th Legislative Session, contact 465-6814. After the 24th Legislative Session they will be available through the Legislative Library at 465-3808.

| TIME | SPEAKER | DISCUSSION |
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| 1:35:47 PM | LOUANNE CHRISTIAN, COMMITTEE ASSISTANT, HOUSE FINANCE COMMITTEE | Provided logistical information for committee members. |
| 1:44:18 PM | MELANIE MILLHORN, DIRECTOR, DIVISION OF RETIREMENT AND BENEFITS, DEPARTMENT OF ADMINISTRATION | Provided a handout: Overview of PERS - TRS (copy on file). She introduced funding, investment, and benefits policies on page 1 of the handout. She referred to page 2 as a summary of public employees' and teachers' earnings, actuarial rates, health costs, employer rates, and funding ratios. She pointed out that the investment return target and calculated rate were not achieved in PERS, which resulted in a cumulative loss and significant medical costs. . She explained the funding ratio and pre-funding of the medical component. |
| 1:51:39 PM | Ms. Millhorn | Discussed TRS actual investment return losses and clarified how health care costs added to the cost of the system. She compared the funding ratio with and without medical benefits costs. |
| 1:53:13 PM | Ms. Millhorn | Reviewed page 3, the Government Accounting Standard Board (GASB) ruling for public sector plans. |
| 1:54:16 PM | Co-Chair Meyer | In response to a question by Co-Chair Meyer, Ms. Millhorn stated that Alaska is in compliance with GASB, as are Ohio, Michigan, and Kentucky, which also account for liability on an accrual basis and pre-fund. She agreed that this system is superior to most states. |
| 1:55:04 PM | ROBERT REYNOLDS, ACTUARIAL CONSULTANT, MERCER HUMAN RESOURCE CONSULTING | Noted that pages 4-7 are an attempt to define the effects of six factors on the funded status of TRS and PERS. He explained that comparing assets and liabilities derives the funded ratio. He pointed to the decline in the funded status during the last three years. |
| 2:00:20 PM | Representative Croft | Asked how House Bill 242 affected the funded status. Ms. Millhorn responded that the two components of House Bill 242, retiree return and enhanced medical benefits, affected the funded status. Representative Croft compared the graphs on pages 4 and 5 to the |

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| | | behavior of the stock market and suggested that non-health assumption changes may be creating problems. He requested more information about them. |
| 2:02:54 PM | Mr. Reynolds | Agreed with Representative Croft that the stock market cannot be influenced, but that investment earnings can be made based on predictions. He referred to page 6, which depicts the changes in funded status of PERS and TRS due to assets and liabilities, noting that assets underperformed by a negligible amount. He pointed out that the graph at the bottom of page 6 breaks down the liabilities even further. |
| 2:08:44 PM | Mr. Reynolds | In response to a question by Representative Croft, clarified how health assumption changes and non-health assumption changes differ between TRS and PERS. Mr. Reynolds explained that the primary difference in the health assumption between TRS and PRS is the health fund change rate, which is a rate used to predict health cost increases. In 2000, a study suggested that the rate used to project health costs needed to be increased. He explained that the same assumptions were used for TRS and PERS, which resulted in a greater effect on the PERS system due to larger medical costs to that system. He related that non-health assumptions are retirement rates, salary increase rates, termination rates and mortality rates, which are studied every five years. He said that the combined effect of those assumptions is different for the two systems because the study is based on actual system experience. Representative Croft summarized page 6 by saying that rising health care costs and assumptions have had a much bigger impact on PERS/TRS than the stock market. Mr. Reynolds agreed. |
| 2:12:58 PM | Ms. Millhorn | Turned to page 8 to show various tier levels and corresponding medical benefits. She pointed out that page 9 contains historical medical insurance information. |
| 2:14:22 PM | Co-Chair Meyer | Inquired if today there would be only enough money to pay for 72 percent of all retirees if everyone retired at |

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| | | once. Ms. Millhorn said yes, but added that the funding ratio is adequate, especially considering that medical costs are pre-funded. Mr. Reynolds elaborated on the financial implications of such a scenario. He agreed that, relative to other systems, the funding ratio looks good. He provided historical funding information and future projections. |
| 2:17:40 PM | REPRESENTATIVE PAUL SEATON | Referred to page 2 and asked for an explanation regarding the differences found in PERS and TRS in board adopted rates and non-medical benefits. |
| 2:18:46 PM | Mr. Reynolds | Answered that the calculated rate is based on the funded status, which is higher for PERS than TRS. Representative Seaton questioned the higher rate of non-medical benefits in PERS. Mr. Reynolds pointed out that the calculated rate is based on the funded ratio for total benefits, which includes medical. |
| 2:22:14 PM | REPRESENTATIVE PEGGY WILSON | Wondered if PERS is limited to 5 percent. Ms. Millhorn replied that it is. Representative Wilson asked if that number should be changed. Ms. Millhorn explained the pros and cons of changing the regulations. In response to a question by Representative Wilson, Ms. Millhorn explained the consequence of incurred liability. |
| 2:25:59 PM | Representative Kelly | Emphasized that funding state retirement systems remains a problem. Ms. Millhorn agreed. |
| 2:27:03 PM | Ms. Millhorn | Referred to page 9 as the historical premium costs of retiree medical insurance. She stated that the Division is concerned about rising medical costs and is looking at measures, such as positive enrollment that can be taken. |
| 2:30:50 PM | Ms. Millhorn | Noted that a letter went out in September 2004 regarding coverage of dependants and proof of enrollment in college. She explained that there are cost issues such as this that the department is addressing. Additionally, there is an initiative between the board and the Division regarding the cost of prescription drugs and a movement toward the use of generic drugs representing a million |

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| | | dollar savings to the plan. |
| 2:32:26 PM | Ms. Millhorn | Spoke to the 5-year contract with AETNA where an agreement on administrative fees was reached. She related that a negotiated network guarantee with Aetna would provide savings to the State of Alaska. |
| 2:34:52 PM | Vice-Chair Stoltze | Commented on pressure to add new coverage to health insurance. He requested accurate and full-cost fiscal notes. |
| 2:35:46 PM | RAY MATIASHOWSKI, COMMISSIONER, DEPARTMENT OF ADMINISTRATION | Responded that the Department is concerned regarding the funding status. He spoke of the time necessary to grind through the assumptions. |
| 2:36:54 PM | Ms. Millhorn | Referenced page 10, which provides a 10-year comparison of expenses by type. She pointed out that costs are rising at a fast rate with the exception of a reduction in administrative expenses in 2004. She noted that the authorized budget for 2004 was \$11.4 million, and the expended budget was \$10.2 million. |
| 2:38:15 PM | Representative Holm | Questioned the relationship between the percentage of increase in employees and dollars. Ms. Millhorn responded that the information was contained in the Valuation Report. |
| 2:38:57 PM | Ms. Millhorn | Related that page 11 indicates the 10-year comparison of expenses by type for TRS. |
| 2:39:33 PM | Representative Wilson | Asked about the difference in refunds between PERS and TRS. Ms. Millhorn commented that the employer's contribution to the refund account is not depicted, only the employee's withdrawal from the system. |
| 2:40:28 PM | Ms. Millhorn | Explained that page 12 summarizes the critical areas between PERS & TRS, the investment return, and actual return since 1987. She pointed out that the middle category demonstrates medical costs. She noted that the mortality table was changed in 2002, which added 2.8 years of benefits to each recipient. She summarized by saying that people are living longer and costs are increasing. |
| 2:41:55 PM | Ms. Millhorn | Highlighted the graph on page 12, PERS and TRS calculated rates and what the boards adopted. |
| 2:42:33 PM | Representative | Commented about the medical cost |

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| | Croft | estimates shown on page 9. |
| 2:43:33 PM | Representative Croft | Suggested that over the last twelve years the price has escalated by 12 percent. |
| 2:43:58 PM | Mr. Reynolds | Interjected that the assumption is that the cost will increase at 12 percent. He explained that a scale of rates is used to arrive at the long-term assumption. |
| 2:45:46 PM | Representative Croft | Clarified that 12 percent is the starting rate and it would decrease. Mr. Reynolds agreed. |
| 2:46:09 PM | Representative Croft | Thought that the 10-year average could be termed a prediction of a problem. Mr. Reynolds agreed. |
| 2:46:51 PM | Representative Croft | Asked how much an 11.5 percent rate would affect the magnitude of the current trend rate. Mr. Reynolds thought that it could bring costs down. |
| 2:47:31 PM | Ms. Millhorn | Explained that page 13 highlights the 5 percent increase by category from FY06 through FY09. She emphasized that the increases are additive. |
| 2:48:29 PM | Representative Wilson | Noted that school districts are different from the university because the university has a defined contribution plan. She asked how changing defined benefit plans to defined contribution plans would affect the proposed scenario. Ms. Millhorn said that that has been considered, recognizing that the unfunded liability must be paid off at the same time. She added that information is available regarding the effect on the state over a 25-year period. |
| 2:50:17 PM | Representative Seaton | Referenced page 12 and asked about the consequences of not adopting the 1994 liability until 2002. He wondered how the trend of waiting is affecting the state. |
| 2:51:15 PM | Mr. Reynolds | Clarified that the 1994 mortality table was adopted in 2000 as a result of a periodic assumption study, which is done every five years. He explained that the effect of that table was about a five percent decline in funded status. He pointed out that there is a newer table now, the effect of which remains to be seen. |
| 2:54:10 PM | Representative Seaton | Suggested it would not make a difference in the current list of savings for PERS and TRS, as they are |

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| | | growing at the maximum rate of contribution. Mr. Reynolds agreed. |
| 2:54:52 PM | Mr. Reynolds | In response to a question from Representative Croft, reported that the calculated rate is a function of the funded status of the systems. He clarified that looking forward 25-years, the rate required to stay at 100 percent over that time period was considerably lower. |
| 2:55:59 PM | Representative Croft | Asked Mr. Reynolds if he would figure the rates at 10 percent, instead of 12 percent on medical, and 8.5 percent, instead of 8.25 percent on the investment return. Mr. Reynolds replied that the Division could address that concern, incorporating the purview of the boards. |
| 2:56:39 PM | Representative Kelly | Asked about impact scenarios. |
| 2:57:23 PM | Mr. Reynolds | Explained that page 18 outlined the actuarial projections and the effect of economic scenarios. He listed the key assumptions behind the graphs on page 19, which highlight three different scenarios and how that would affect contribution rates. |
| 3:00:49 PM | Mr. Reynolds | Continued, noting an increase of 5 percent for the next several years. He pointed out that a lag is indicated in attempting to achieve the calculated rate. |
| 3:01:33 PM | Mr. Reynolds | Related that pages 20 & 21 show the analogous information for TRS, with page 20 indicating assumptions on the actuarial projections and the effect of economic scenarios. He described page 21 as TRS actuarial projections and the effect of economic scenarios on the contribution rates. |
| 3:02:48 PM | Representative Croft | Asked if the 7-12 percent contribution rates, which have existed in the past, are now going to be 33-50 percent. Mr. Reynolds spoke to the changes in the proposed contribution rates. He explained that the intention is to get to 100 percent funded status after 25-years. |
| 3:03:51 PM | Mr. Reynolds | Commented that the charts on pages 22 & 23 were developed to predict what effect a new tier might have on contribution rates in the future. He pointed out that additional information |

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| | | is available from the Division regarding that benefit level. Page 22 indicates the stress on future contributions with the rate increasing and then declining after a 30-year increase. Also indicated are the impacts on the rates in the future, resulting in a 7 percent decrease. He concluded that it would take many years to realize the full savings and would affect only new membership. |
| 3:06:48 PM | Mr. Reynolds | Indicated that page 23 shows the same information for the PERS system. |
| 3:07:40 PM | Representative Kelly | Suggested that in order to determine the full cost, the employee contribution should be included. Mr. Reynolds agreed, pointing out that the material is available on the Division's website. |
| 3:08:39 PM | Ms. Millhorn | Addressed the various employee contribution rates. She pointed out that a survey showed that employers wanted to see employees bear a larger burden for benefits. |
| 3:09:27 PM | Representative Wilson | Summarized that down the line it would ease the state's burden but place a higher burden on the employee. Ms. Millhorn noted that some of the risk would be shifted to the employee. She repeated that more information is available online. |
| 3:12:17 PM | Ms. Millhorn | Provided timelines for PERS & TRS and concluded the presentation on the PERS and TRS proposed system. |
| 3:13:28 PM | Ms. Millhorn | In response to a question by Representative Seaton, explained that the graph on page 23 shows what it takes to pay for the normal costs of existing benefits and unfunded liabilities, so that by 2029 there is a return to normal cost rates. She explained past service cost and a proposal to look at an 8 percent cost rate with a vastly reduced risk. |
| 3:15:56 PM | Mr. Reynolds | Noted that the quick answer is somewhat arbitrary, but is based on amortization methods and time periods. He emphasized that the methodology has been arrived at by due process. He explained various amortization periods and methods. |
| 3:18:21 PM | Representative Seaton | Asked about the calculation method. Mr. Reynolds replied that the method is |

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| | | similar to a mortgage. |
| 3:19:50 PM | Representative Holm | Questioned whether it is the Administration or Legislature's problem, given that the board has not voted for a tier 4. Commissioner Matiashowski answered that it is unknown right now; there are no silver bullets, and there are limited options. He added that he couldn't say today who would introduce legislation. |
| 3:21:45 PM | Representative Holm | Asked for Commissioner Matiashowski thoughts on a defined contribution plan versus a defined benefits plan. Commissioner Matiashowski replied that the pension plan is set in statute as a benefit for PERS. Ms. Millhorn referred to a 1978 attorney general's opinion that addressed the retirement policy. Representative Holm brought up the fact that municipalities have taken a hit, and he asked if the would be addressing this concern. Commissioner Matiashowski replied that the Governor's budget proposal included a 5 percent increase over the next 2 years for municipalities and school districts. |
| 3:25:25 PM | Representative Croft | Observed how little impact a new tier has on solving the problems of the retirement systems. He pointed out costs incurred when decreasing retirement benefits for teachers. |
| 3:26:43 PM | Commissioner Matiashowski | Agreed with Representative Croft, but pointed out that a defined benefits plan burdens the employer exclusively with any investment risk, whereas contributions would be lower in the future under a defined contributions plan if the entire employee population becomes covered. He termed it "significant" that the employee has all the risk. |
| 3:28:16 PM | Representative Kelly | Asked if the comparison of alternative 1 and alternative 2 only applies to tier 4. Ms. Millhorn replied that it does. |
| | | <u>ADJOURNMENT</u> |
| | | The meeting was adjourned at 3:30 PM |