

ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON WAYS AND MEANS

January 20, 2006
9:14 a.m.

MEMBERS PRESENT

Representative Bruce Weyhrauch, Chair
Representative Peggy Wilson
Representative Max Gruenberg
Representative Carl Moses

MEMBERS ABSENT

Representative Norman Rokeberg
Representative Ralph Samuels
Representative Paul Seaton

OTHER LEGISLATORS PRESENT

Representative Mike Kelly

COMMITTEE CALENDAR

HOUSE BILL NO. 374

"An Act relating to establishment of a retirement benefit liability account in the Department of Revenue and redirecting deposit of annual dividends of the Alaska Housing Finance Corporation to that account; and providing for an effective date."

- HEARD AND HELD

HOUSE BILL NO. 375

"An Act relating to the retirement benefit liability account and appropriations from that account; relating to deposits of certain income earned on money received as a result of State v. Amerada Hess, et al., 1JU-77-847 Civ. (Superior Court, First Judicial District); and providing for an effective date."

- HEARD AND HELD

PREVIOUS COMMITTEE ACTION

BILL: HB 374

SHORT TITLE: RETIREMENT BENEFIT LIABILITY ACCT/AHFC

SPONSOR(S): WAYS & MEANS

01/17/06 (H) READ THE FIRST TIME - REFERRALS
01/17/06 (H) W&M, STA, FIN
01/20/06 (H) W&M AT 9:00 AM CAPITOL 106

BILL: HB 375

SHORT TITLE: RETIREMENT BENEFIT LIABILITY ACCT/PF
SPONSOR(S): WAYS & MEANS

01/17/06 (H) READ THE FIRST TIME - REFERRALS
01/17/06 (H) W&M, STA, FIN
01/20/06 (H) W&M AT 9:00 AM CAPITOL 106

WITNESS REGISTER

GARY BADER, Chief Investment Officer
Treasury Division
Department of Revenue
Juneau, Alaska

POSITION STATEMENT: Answered questions regarding Alaska's retirement system.

TOM BOUTIN, Deputy Commissioner
Treasury Division
Department of Revenue
Juneau, Alaska

POSITION STATEMENT: Answered questions regarding Alaska's retirement system.

KEVIN BROOKS, Deputy Commissioner
Department of Administration
Juneau, Alaska

POSITION STATEMENT: Answered questions regarding Alaska's retirement system.

MELANIE MILLHORN, Director
Health Benefits Section
Division of Retirement and Benefits
Department of Administration
Juneau, Alaska

POSITION STATEMENT: Answered questions regarding Alaska's retirement system.

ACTION NARRATIVE

CHAIR BRUCE WEYHRAUCH called the House Special Committee on Ways and Means meeting to order at 9:14:31 AM. Representatives

Weyhrauch, Gruenberg, Moses, and Wilson were present at the call to order. Representative Mike Kelly was also in attendance.

HB 374-RETIREMENT BENEFIT LIABILITY ACCT/AHFC
HB 375-RETIREMENT BENEFIT LIABILITY ACCT/PF

[9:14:55 AM](#)

CHAIR WEYHRAUCH announced that the first order of business would be HOUSE BILL NO. 374, "An Act relating to establishment of a retirement benefit liability account in the Department of Revenue and redirecting deposit of annual dividends of the Alaska Housing Finance Corporation to that account; and providing for an effective date." and HOUSE BILL NO. 375, "An Act relating to the retirement benefit liability account and appropriations from that account; relating to deposits of certain income earned on money received as a result of State v. Amerada Hess, et al., 1JU-77-847 Civ. (Superior Court, First Judicial District); and providing for an effective date."

CHAIR WEYHRAUCH said both bills on the agenda today deal with retirement liability accounts, and HB 376 accompanies these bills, which is a simple appropriation bill that has been referred to the House Finance Committee. He noted that various interest groups in the state, including the Alaska Municipal League (AML) and the Alaska State Chamber of Commerce, continue to demand a statewide fiscal plan. These groups have also prioritized a desire to address the Public Employee Retirement System (PERS) and Teachers Retirement System (TRS) unfunded liability. He said that the House Special Committee on Ways and Means has taken much testimony from the public, communities and other interest groups on the topic, and the solution to this is simple: cash. "All we have to do is appropriate all the money there is, and the problem is solved."

CHAIR WEYHRAUCH said that is not a realistic political solution since there are other needs in the state. "Since we've dealt with the future of the retirement system through the passage of SB 141, we still have an existing problem with the unfunded liability," which last year was \$5.7 billion. He said if the growth of that is not arrested, it will create a huge deficit problem. If the problem is not addressed, the state will have to use money from the constitutional budget reserve, enter into additional kinds of indebtedness through bonding, use earning reserves of the permanent fund, or take the money out of the permanent fund itself. He said the bonding companies and rating

agencies are going to demand some action by the state to take care of this problem.

CHAIR WEYHRAUCH said this is a long-term, political issue. He added, "What I've tried to do is take the testimony of the public that we have had this past year, and take some of the political rhetoric that we've heard from various groups on how to solve the problem and put it into a strategic long term context." He said a recurring source of money that could be used "is the North Slope." He said other resource development money and interest on investments provide a recurring source of money, "but essentially that is the only source of revenue that we have of any significant size...to address the unfunded liability."

CHAIR WEYHRAUCH stated that today's bills will set up special accounts that can take money from other sources and use it to pay into the unfunded liabilities of PERS and TRS. Related is the appropriation bill that the House Finance Committee will deal with, which will ultimately appropriate \$438 million into both systems, with the majority going into TRS for the benefit of public education. He said that some previous testimony has indicated that there may be other sources of revenue for PERS. He stated his desire to get the bills introduced today, and he would like to get many questions from the committee so members understand "what's going on with the bills." He stated that he wants to know the position of the Alaska Retirement Management Board (ARMB), which has just hired a new actuary, Buck Consultants. He said he wants to know the size of the unfunded liability and its impact to the state's finances.

[9:24:16 AM](#)

GARY BADER, Chief Investment Officer, Treasury Division, Department of Revenue, said the Department of Revenue is staff to the newly formed Alaska Retirement Management Board (ARMB), which consists of nine trustees and has met three times. He listed the accomplishments of the board including working on a report to the legislature that is due in a few days. He said ARMB has not determined how it will respond to the proposed legislation. He said a new actuary has been hired, but there will not be actuarial findings until March. The board has listed long-term recommendations, and one of those goals is "to fully fund retirement obligations to our public employees with a minimal impact on services to the residents of Alaska." Mr. Bader said that in pursuit of that goal, the likely recommendations of ARMB will include some combination of the

following: extending the payoff period, requesting contributions to the system, and adopting a funding strategy that will set a limit on the rate of employer contributions.

MR. BADER said today's bills have funding source issues that can only be resolved by the legislature. "I am confident the board would welcome the infusion of funds into the system if the funding source issues can be resolved," he concluded. Then in response to questions, Mr. Bader said there is considerable concern regarding the escalation of employer contribution rates that he believes will go up to 50 percent for TRS, so the ARMB may have suggestions when they have enough information.

[9:29:00 AM](#)

REPRESENTATIVE GRUENBERG asked what Mr. Bader meant by extending the payoff period.

[9:29:41 AM](#)

MR. BADER said the concept is similar to a home mortgage and extending the payoff from 25 to 30 years would lower the amount of the annual contributions to the system.

REPRESENTATIVE GRUENBERG noted that the bills before the committee suggest paying the debt off now, which is the opposite of Mr. Bader's position on extending the payoff. He asked if an extension could be done legislatively or administratively.

MR. BADER said that he believes ARMB's intention "is to submit questions to Buck [Consulting]--there are accounting issues involved in extending the liability period--to get their input on the feasibility of extending that payoff period." He said, "The question [ARMB] will probably put to Buck is, here are these three tools, and then try and find an optimum combination of those tools: extending liability, annual contributions--they're looking at annual contributions not because they think it wouldn't be nice to have the full amount paid in advance, but consider that so unlikely as to probably eliminate it from one of the approaches, and then also a cap on employer contribution rates, because it's my view that the committee felt that it's just unrealistic to think that the rates can be allowed to escalate up to the amounts projected in the last actuarial valuation."

[9:31:40 AM](#)

CHAIR WEYHRAUCH said the last person that is going to be hired on midnight, June 30, 2006, is going to be a tier 3 employee. That person can retire after thirty years, so "we have to fund the system to finance that employee's retirement and health for 30 years, so why would it make more sense to do it to 30 years as opposed to anything less?"

MR. BADER said that is a question the ARMB will ask the actuary.

[9:32:27 AM](#)

CHAIR WEYHRAUCH referred to Representative Gruenberg's question, and asked Mr. Bader if [an extension] can be done administratively or legislatively.

MR. BADER said the Department of Administration could answer that, but he believes it does not require legislation.

[9:33:02 AM](#)

REPRESENTATIVE WILSON said extending the payoff will cost more in the long run.

[9:33:25 AM](#)

REPRESENTATIVE GRUENBERG said he feels that the public is looking to the legislature for some leadership. It is a political problem as well as an accounting one. He said there are 110 days left in the session. "How long will it take the ARM board to get their proposal to us?"

MR. BADER said he does not have an answer because it depends on "the speed with which the actuary completes their work." He said the actuary will first "attempt to replicate the 2004 valuation of the fund that was done by Mercer in order to assure themselves, I guess, that their data is correct—I don't really understand the reason for that." He said SB 141 also requires a second actuary, and the Department of Revenue is in the process of hiring one who will report directly to ARMB. "That's not to say that Buck [Consulting] is not accessible to the ARM board, they are accessible, the commissioner of administration has said that they shall be." He said the focus of ARMB is getting this required report to the legislature. He said that at the next board meeting they will take action to put the questions of changing the various assumptions to the actuary.

[9:35:32 AM](#)

REPRESENTATIVE GRUENBERG said the length of time and the terms of a payoff can vary, but he asked Mr. Bader if the legislature can begin the process.

[9:36:51 AM](#)

MR. BADER said that in the report to the legislature there is language that says that the board knows there is a need for additional funding into the system. He said, "We don't have to have the exact formula, it's \$5.5 billion we know in arrears, any amount would be a first step." He added that he thinks ARMB is promoting an infusion of funds by the legislature and "the sooner, the better."

REPRESENTATIVE GRUENBERG said the bills before the committee deal with funding and the source of funding, but "if we are looking at this as a three-legged stool, I am suggesting, Mr. Chair, that this committee might consider putting conceptually the other two legs in here too, realizing that they'll have to be tweaked as we go through the system. But at least the recommendation from this committee from the get-go would be that this be part of a 3-pronged approach. And we put them in the bill, and we try to get the problem at least dealt with in the hearing process, and as we get more information, they can fill in the figures."

[9:38:22 AM](#)

CHAIR WEYHRAUCH said the committee needs more testimony and information on extending the payoff period and limiting employer contributions, but the third approach of requesting additional contributions into the system "is a political decision that we have to make." He noted that the three bills before the committee today, HB 374, HB 375 and HB 376, deal with [additional contributions], "and it is my understanding that [ARMB] doesn't have a position on any one of these bills."

MR. BADER said that was correct.

[9:39:23 AM](#)

MR. BADER said the board's intent on a cap on the contribution rate "would be to determine a cap, not in the sense of a hard law," but as a tool "to try and hone in on the length of the period of amortization, the amount of contributions to the system that they in some way say, 'We have to constrain this

model to some level of contribution rate that is doable.'" He said it would be something far less than 55 percent.

[9:40:08 AM](#)

REPRESENTATIVE WILSON asked if it would be more feasible to use a cap if the legislature paid a lump sum of \$500,000 to the principal.

MR. BADER said that is correct, but the remaining debt would have to be amortized over 25 years, so it may not have as large of an impact on the employer contribution rate as the approach suggested in the legislation before the committee.

[9:41:20 AM](#)

REPRESENTATIVE WILSON asked if the actuaries will be able to give several scenarios like that for the legislature to consider, with some actual facts.

MR. BADER said, "I believe it is the board's intent to ask them for several scenarios."

[9:41:54 AM](#)

TOM BOUTIN, Deputy Commissioner, Treasury Division, Department of Revenue, said the department put in zero fiscal notes for HB 374 and HB 375 to reflect that the transaction cost would be minimal. He said he is not speaking to where in the budget the money would "instead go; that is a policy call." He said the department would have "the money for about one quarter before it went out to employers to be then coming back to the sponsor plans." He added that he spoke with Kevin Brooks about the money instead flowing directly to the sponsor plans to be credited to the employers in the same amounts, thereby avoiding transaction costs and the loss of investment returns that happens by sending the money out to the employers and having the same money come back.

[9:43:42 AM](#)

CHAIR WEYHRAUCH asked if it is advisable to put the money directly into PERS instead of creating these accounts.

[9:43:56 AM](#)

MR. BOUTIN said in the case of HB 374 the dividend would flow to the account set up by the bill and then it would flow out to the employers, and then the employers would send the same amount back in the form of additional employer contributions. He said the money, instead, could flow directly into the PERS and TRS investments.

[9:44:51 AM](#)

CHAIR WEYHRAUCH asked what the unfunded liability is today, and what it means in terms of the budget.

[9:45:18 AM](#)

MR. BOUTIN said those are the things the actuary is supposed to provide. He added that "the examinations now of the financial picture are driven by the employer contribution rates. Credit ratings of the state and—to the best of my knowledge—of the municipalities are not in any way jeopardized, weakened or suffering because of the unfunded pension liabilities in PERS and TRS. PERS and TRS are still in the top tier among states, so far as funding and plan reliability, and are either not mentioned, or are not mentioned in a cautionary way, by the credit rating agencies when they review the credit of the state or Alaska municipalities."

[9:46:44 AM](#)

CHAIR WEYHRAUCH asked the return on the investment of the money in the PERS and TRS system.

[9:47:01 AM](#)

MR. BADER said PERS earned 8.95 percent and TRS earned 9.0 percent last year, and the previous year it was over 14 percent. The three years prior to those were below the actuarial rate of return that the system expects to receive. Over the past 13.5 years, the retirement funds have earned higher than the 8.25 percent anticipated by the actuary, he stated.

CHAIR WEYHRAUCH asked what the growth of the unfunded liability portion of the debt has been.

MR. BADER said he does not know.

[9:48:08 AM](#)

REPRESENTATIVE GRUENBERG said the unfunded liability last year was 5.7 billion. What is it now?

MR. BOUTIN said he has no idea, and the actuary will find that out.

MR. BADER said there are many things that affect the actuarial calculation like health, longevity, and salary increases.

REPRESENTATIVE GRUENBERG asked how many other states have similar problems.

MR. BOUTIN said probably all of them.

REPRESENTATIVE GRUENBERG asked if the federal government is considering giving assistance.

MR. BOUTIN suggested asking the Division of Retirement.

[9:50:55 AM](#)

CHAIR WEYHRAUCH asked what report was coming and when.

[9:52:22 AM](#)

MR. BADER said he referred to an ARMB report that was required by SB 141 and is due on January 24, 2006.

CHAIR WEYHRAUCH asked to have the report presented to the committee next Wednesday.

[9:53:27 AM](#)

KEVIN BROOKS, Deputy Commissioner, Department of Administration (DOA), said that the work with ARMB is collaborative with DOA and Department of Revenue. He said the ARMB report was jointly authored by the two departments. He stated that a cap on the contribution rate is not necessary in statute. He added that SB 141 established a floor and required the actuarially determined normal rate for contribution to be met each year by employers, which he said prevents problems seen in the late 1990s when rates dropped and compounded the market-loss problems. The floor is the normal rate, which is just over 13 percent.

CHAIR WEYHRAUCH asked if that is in effect now.

MR. BROOKS said those are developed for FY 2007.

CHAIR WEYHRAUCH asked what percentage of the PERS and TRS entities are below that.

[9:57:31 AM](#)

MR. BROOKS said he did not know.

CHAIR WEYHRAUCH asked if there will be a huge jump in required employer contributions after July 1.

MELANIE MILLHORN, Director, Health Benefits Section, Division of Retirement and Benefits, Department of Administration, said it will be a very small number. It would be less than 12 out of 161 employers.

[9:58:47 AM](#)

MR. BROOKS said there are Internal Revenue Service rules restricting extension of the payoff period.

CHAIR WEYHRAUCH asked if the legislature or administration would extend the payoff.

MR. BROOKS said it does not require statute.

CHAIR WEYHRAUCH asked what is the upper limit on employer contributions.

MR. BROOKS said there is not an upper limit, but anything in excess of 50 percent is hard to sustain. "We're looking for a balance between extending the payoff contributions and other things, and arriving at a rate that is sustainable, that employers can afford to pay."

[10:00:32 AM](#)

CHAIR WEYHRAUCH asked the size and growth rate of the unfunded liability.

MR. BROOKS said the administration is looking at it. He said when the Murkowski administration came into office it was \$4.2 billion. A year later, in 2003, it had grown to \$5 billion. The most recent number is \$5.7 billion, he said. He said there will be a report from Buck in March. He added that the analysis being done is based on over 20 assumptions, from health costs to

earnings projections. Buck will try to replicate data from Mercer, so the estimates will compare.

[10:02:23 AM](#)

CHAIR WEYHRAUCH asked if the report will be held until there is a second opinion.

[10:02:40 AM](#)

MR. BROOKS said the report will not be held. He said the appropriation made in FY 2006 to pay for the 5 percent increase did go directly to the funds. He added that the state has the ability to allocate it to employers, and it is more efficient that way instead of how today's legislation does it.

[10:03:57 AM](#)

CHAIR WEYHRAUCH asked for, in writing, why it is more efficient.

REPRESENTATIVE WILSON said she has heard that when the employers got money this year some of them used it to reduce the percentage and others didn't.

MR. BROOKS said that however a cash infusion is implemented, it is important that employers can contribute at a rate they want.

[10:04:56 AM](#)

CHAIR WEYHRAUCH said he has a legal analysis on pension obligation bonds from Tam Cook, Director, Legislative Legal and Research Services.

[10:05:24 AM](#)

CHAIR WEYHRAUCH said he doesn't want to wait until March. The liability isn't getting any smaller.

[10:06:13 AM](#)

REPRESENTATIVE GRUENBERG said the other "two prongs of this stool" can be done without legislative action, and he wants to explore that with the administration.

[10:06:56 AM](#)

CHAIR WEYHRAUCH said the state finances the contribution to the employee under the defined contribution plan, and he asked if the state has to provide a similar amount of money to those employees under the defined benefit plan.

MR. BROOKS said the analysis from actuaries contemplates a contribution rate that would be assessed on employee payroll regardless of the tier an employee is in. "The differential between that normal cost and the actuarially determined cost would still be the amount that would be going to retire the unfunded liability."

CHAIR WEYHRAUCH said that at some point the state should be able to determine what the rate of savings is by having the new tier.

MR. BROOKS said that would become apparent over time.

CHAIR WEYHRAUCH questioned if the state really realizes the savings by having a new tier because it has to give an identical amount, or some contribution, to the existing system. "So it is not saving money. It's still spending the same amount or more."

MR. BROOKS said the normal cost of different tier employees can be determined, and those will be different. "And what we do know is in a defined contribution plan, the amount for that employee in tier four is absolutely determined. There is no unknown amount for future medical costs." He said it takes the uncertainty out of the rate going forward. But the normal rate can be determined for the different tiers, and the differential with the actuarially determined rate would be the amount that is contributed toward the unfunded liability.

[10:09:33 AM](#)

[HB 374 and HB 375 were held over.]

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Ways and Means meeting was adjourned at 10:09.