

**ALASKA STATE LEGISLATURE**  
**HOUSE SPECIAL COMMITTEE ON WAYS AND MEANS**

January 27, 2006

9:08 a.m.

**MEMBERS PRESENT**

Representative Bruce Weyhrauch, Chair  
Representative Norman Rokeberg  
Representative Ralph Samuels  
Representative Paul Seaton  
Representative Peggy Wilson  
Representative Max Gruenberg

**MEMBERS ABSENT**

Representative Carl Moses

**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

01/20/06 (H) Heard & Held  
01/20/06 (H) MINUTE(W&M)  
01/25/06 (H) W&M AT 9:00 AM CAPITOL 106  
01/25/06 (H) Heard & Held  
01/25/06 (H) MINUTE(W&M)  
01/27/06 (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  
01/20/06 (H) Heard & Held  
01/20/06 (H) MINUTE(W&M)  
01/25/06 (H) W&M AT 9:00 AM CAPITOL 106  
01/25/06 (H) Heard & Held  
01/25/06 (H) MINUTE(W&M)  
01/27/06 (H) W&M AT 9:00 AM CAPITOL 106

**WITNESS REGISTER**

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

POSITION STATEMENT: During discussion of HB 374 and HB 375,  
provided information and answered questions.

FREDA MILLER, Benefits Manager  
Health Benefits Section  
Division of Retirement & Benefits  
Department of Administration  
Juneau, Alaska

POSITION STATEMENT: During discussion of HB 374 and HB 375,  
answered a question.

**ACTION NARRATIVE**

**CHAIR BRUCE WEYHRAUCH** called the House Special Committee on Ways  
and Means meeting to order at 9:08:43 AM. Representatives  
Weyhrauch, Gruenberg, and Samuels were present at the call to  
order. Representatives Rokeberg, Seaton, and Wilson arrived as  
the meeting was in progress.

9:08:55 AM

CHAIR WEYHRAUCH announced that the only 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."

9:09:28 AM

MELANIE MILLHORN, Director, Health Benefits Section, Division of Retirement & Benefits, Department of Administration (DOA), continued her testimony from the previous meeting, and referred to the DOA's report entitled, "AlaskaCare Health Plan Health Cost Analysis". She recapped the three primary reasons for the unfunded liability for the Public Employees' Retirement System (PERS) and Teachers' Retirement System (TRS) which are: loss of investment income, rising health care costs, and changes in actuarial assumptions.

9:10:10 AM

REPRESENTATIVE GRUENBERG asked if Ms. Millhorn would prioritize the "the problem each of those [reasons] causes."

MS. MILLHORN said the actuarial consultant prepared information that applies percentages to these various areas, comparing data from a 10-year and 3-year period. She said she could not, at this time, provide the ranking information in which Representative Gruenberg was interested but recalled that the change in net assets during the 10-year period is smaller compared to the change in liabilities; however, the results are reversed during the 3-year period. She said she would provide the committee with the actual percentages once determined.

MS. MILLHORN directed the committee's attention to page 5 of the health cost analysis, which addresses "the various different initiatives that the [Division of Retirement and Benefits] has

undertaken in order to manage the health care costs." She pointed out that there are two vehicles available to manage health care costs: plan design in which an individual can make changes to manage and reduce costs to his/her plan, and eligibility audits.

MS. MILLHORN said Aetna [Inc], the third party administrator for the State of Alaska's health plans, has negotiated discounts with [health] facilities and physician providers which, when frequented by members for health care services, has resulted in substantial network savings. She clarified that the \$35.2 million savings for fiscal year 2005 (FY 05) shown near the top of page 5 of the report includes the savings of the active plan employees; the amount of savings for just the retiree plan would be \$31.2 million. Additionally, she explained, the total estimated retiree savings for calendar year 2006 (CY 06) is \$65.2 million, not the \$69.2 million shown in the report, which again includes the amount for the active plan at \$4 million.

MS. MILLHORN then directed the committee's attention to the graph at the bottom of page 5. She explained that the percentages in the top line are determined annually by the [division's] benefits consultant, Deloitte Consulting, which compares claims costs, population, next-year premium projections from Aetna, and the actuarial trend to determine what the premium amount increase needs to be in order to pay for administrative costs and health care costs.

MS. MILLHORN highlighted the importance of reviewing the reserve balance when establishing the premium. The Deloitte Consulting projections for the last two years, she explained, have favorably differed from what was actually experienced, with claims costs that were well below the national trend. She cited figures from the financial statements showing that as of June 30, 2005, the reserve amount in the retiree health plan increased from \$173 million to \$236 million. "What Deloitte [Consulting] has recommended as a reserve parameter is between 15 and 25 percent when you have a health care plan the size of our health care plan for our retirees." She opined that the margin of the reserve amount for the retiree [plan], between 41 and 44 percent, is favorable, although two years of favorable increases does not remedy the unfunded liability. Therefore, the plan should continue to be managed in a way that "allows us to have that favorable experience," she said.

[9:18:29 AM](#)

REPRESENTATIVE WILSON related her belief that it's wise to proceed as [Ms. Millhorn] suggested.

[9:18:52 AM](#)

REPRESENTATIVE GRUENBERG asked if Ms. Millhorn had observed that a provider, who is the only local provider of a particular service in a particular location is less likely to participate at the preferred rate than in locations where there are several providers of the same service.

MS. MILLHORN agreed that this is the experience in Alaska. Using Juneau as an example, she said, "We may not have the number of physicians or surgeons in any one particular area to actually create or incentivize that provider to enter into a negotiated agreement with Aetna in order to reduce those costs because the competition level does not necessitate that movement for that physician." In further response to Representative Gruenberg's question regarding providing incentives to physicians, Ms. Millhorn said that each of the two Aetna offices in Juneau and Anchorage, Alaska, have one staff member assigned to engage providers in discussion on this topic.

[9:21:34 AM](#)

REPRESENTATIVE GRUENBERG asked if there was "any methodology the [DOA] uses to audit Aetna's overhead itself."

MS. MILLHORN explained that every year Aetna provides a contract amount for the following fiscal year, then the DOA and Aetna engage in negotiations such that they review ways to reduce administrative fees. Ultimately, the contract agreement provision is sent to Deloitte Consulting for review and advice on any proposed changes.

[9:23:01 AM](#)

REPRESENTATIVE GRUENBERG compared the 15-25 percent reserve level that Deloitte Consulting recommended to the actual 41-44 percent level the state currently has in reserve, and asked whether this amount is "excessive in this time of crisis."

MS. MILLHORN explained that in FY 04, \$20 million of the reserve amount was transferred from a shorter term investment account, with a rate of return of 4.4 percent, to pay medical claims each month and then transferred back into the respective retirement systems from which the funds originated, approximately \$16

million went back into PERS. She said there have been discussions with the DOA commissioner and Deloitte Consulting involving recommendations "to transfer from the retiree health reserve amount back to the plans as we did in 2004." In further response to Representative Gruenberg, she said the amount [transferred], would be between \$20 and \$25 million.

9:25:13 AM

MS. MILLHORN said what is notable in CY 06 - in the grid at the bottom of page 5 of the report - is that the medical costs for the AlaskaCare Plan retirees is lower; however, prescription drug costs have risen at a trend of 20 to 22 percent. Deloitte Consulting, she explained, arrives at that premium trend by reviewing the experience of retirees using prescription drugs, which amounts to \$96 million out of a total \$256 million for the claims costs in 2005. Therefore, that's an area deserving attention, and at this point, there is discussion regarding a closed formulary in which the retiree receives prescriptions he/she needs while reducing cost to the plan because not all drugs are made available. She confirmed Chair Weyhrauch's observation, in the chart at the top of page 6, that whereas the number of member retirees has increased 8 percent in 4 years, the health care costs increased 120 percent in that same time.

9:28:31 AM

REPRESENTATIVE GRUENBERG recalled reading "how other states have reduced the cost of pharmaceuticals by drug-pooling purchasing agreements," and asked if this option has been examined.

MS. MILLHORN said she has not been involved in discussions with other states regarding pooling options but affirmed that all avenues in managing health care costs would be considered.

REPRESENTATIVE ROKEBERG, returning to Ms. Millhorn's comment on transitioning to a closed formulary for retirees, asked how this would work given the "case law shift of benefits."

MS. MILLHORN said that any plan changes to retirees are considered carefully and in concert with the Department of Law (DOL). As to discretion, she explained, it doesn't create a diminishment of benefits, but "if the member can still receive the service and/or the drug prescription that they need, it doesn't distill itself down into a diminishment of benefits when it's about choice or discretion."

9:31:34 AM

MS. MILLHORN agreed with Representative Rokeberg regarding being able to maintain ordinary and customary [health care] services when specifying, in the closed formulary, what brands of drugs are available or when members can choose generic [drugs]. Ms. Millhorn commented that it is very helpful to look at what other state systems are doing in regard to retiree health care. She said a report compiled by Workplace Economics, Inc., commissioned by AARP, determined that 24 percent of the states do not provide retiree health benefits to their members unless that member pays the entire premium, 44 percent of states are engaged in a cost share system with their members, and 22 percent have what [Alaska] has which is a system-paid medical benefit.

MS. MILLHORN said that SB 141 addresses rising health care costs, of which 75 percent accrue to those members who are between retirement age and age 65, when a person's health care is coordinated with Medicare. She opined that "SB 141 really does inject cost savings to the plan and it also cost shares with the member." Returning to an earlier question, Ms. Millhorn expressed her opinion that employers have insulated members from the true cost of health care and that members should be educated in being good health care consumers as well as engaged and incentivized with these costs just as they might, in the example she gave, in purchasing a new car.

9:36:12 AM

REPRESENTATIVE GRUENBERG asked if there were other plans in existence that devised incentives to members for holding costs down.

MS. MILLHORN replied yes, and informed the committee of the High Deductible Health Plan (HDHP) with attached Health Savings Accounts in which members can build wellness and disease management into their plans and pay 100 percent of preventative care. Recent research has shown these kinds of plan features to be very beneficial, she said, and this avenue is currently being explored as a health care opportunity for [Alaska PERS/TRS] members along with several others listed on page 7 of the report.

MS. MILLHORN said the state is, at present, working with Aetna on a preferred provider opportunity in Anchorage for retired state employees. There currently is a preferred provider

arrangement with Providence Hospital in Anchorage for active employees, and therefore when active employees go to other hospitals in [the Anchorage] area, members pay an extra 20 percent, she explained.

[9:39:07 AM](#)

REPRESENTATIVE ROKEBERG asked how the state could legally require retired employees to seek services with a preferred provider.

MS. MILLHORN explained that in discussions with the DOL, steering retired employees to preferred providers is allowable as long as there is no diminishment of benefits. In further response to Representative Rokeberg, Ms. Millhorn said there has been research on disease management as it relates to the state's retiree population but this initiative was put on hold for several reasons, including the voluntary nature of the program, the cost to the plan at approximately \$300,000 per year combined with the fact that any savings to members 65 or older would accrue to Medicare or the federal government and not to the state plan, and the fact that Aetna has never before offered a disease management plan for retirees. She said the state will consider the results of the three-year pilot program Medicare is currently performing on disease management for retirees, and in which Aetna is participating, before going further. In response to Chair Weyhrauch, Ms. Millhorn clarified that "PPO" is the acronym for preferred provider organization.

[9:43:16 AM](#)

FREDA MILLER, Benefits Manager, Health Benefits Section, Division of Retirement & Benefits, Department of Administration, in responding to a question by Representative Wilson, explained that there are several ways to express dispense as written (DAW). However, unless the doctor has indicated on the DAW prescription that a generic drug is acceptable as well, then the [pharmacy] has to dispense the brand the doctor has written.

REPRESENTATIVE WILSON opined that the definition for DAW, provided at the bottom of page 7 of the report, is misleading in that it says the pharmacy may substitute a less expensive drug even with DAW written on the script.

MS. MILLER said because of the different types of DAW, she would need to do research before clarifying further.

[9:44:26 AM](#)

MS. MILLHORN referred to the last page of the report which summarizes the current PERS and TRS members by category: active employees, deferred vested, deferred, and retired. Of note, she said, is the fact that the retiree population is growing, a factor that can't be controlled, and costs are going to rise as the population increases. She directed the committee's attention to the Tier 1 column which will "continue to be costly to the retirement plans."

MS. MILLHORN then directed the committee's attention to her January 26, 2006, letter which answered questions brought up at the previous meeting. She informed the committee that 37 percent of active members who participate in the Select Benefits Health Plan have enrolled in the economy plan. Furthermore, she explained, the state employee enrolled in this plan has cost share associated with it which goes away to a large degree when that employee retires.

[9:47:10 AM](#)

REPRESENTATIVE ROKEBERG asked if he were correct in understanding that regardless of which plan [the employee] enrolls - economy or premium - when that employee retires his/her [coverage] defaults to whatever the retiree plan is.

MS. MILLHORN confirmed that to be correct and indicated that the only substantive change is under SB 141 which has cost share injected into that health care plan. She pointed out that as soon as the employee is eligible for Medicare, he/she still has the premium [to pay], 30 percent down to 10 percent. Under SB 141, she explained, new members enrolled in the economy plan will, to a large degree, be in the same plan they have when they retire because of the cost share factor. She confirmed that Representative Wilson was correct in her understanding that under SB 141, whatever plan an active employee has selected, is the plan he/she will have upon retirement. Ms. Millhorn emphasized that under SB 141, the focus is not so much under which plan an employee retires as to the fact that there are some mechanisms in the plan design itself by which the member shares in costs, and so is more likely to be engaged in the process - doing research and comparing costs of available service providers, physicians and prescription drugs - in order to select the best option.

[9:50:52 AM](#)

REPRESENTATIVE WILSON asked if she was correct in understanding that under SB 141, "they pay a part of the premium and when they retire, they still pay part of that premium?"

MS. MILLHORN replied yes. She added that the way SB 141 is designed in relation to the medical component, a Medicare-eligible individual pays a percentage of that premium based on the years of service: between 10 and 14 years, the member would pay 30 percent and after 30 years, the member would pay 10 percent. Additionally, the member will have a health reimbursement account, which is designed to pay medical expenditures for the premium and which, Ms. Millhorn opined, will have members "wisely spend out of that account."

[9:52:02 AM](#)

REPRESENTATIVE WILSON queried, "When they retire, they pay a portion of the premium, yes or no?"

MS. MILLHORN reiterated that is correct, [the retiree would pay a portion of the premium].

[9:52:29 AM](#)

MS. MILLHORN directed the committee's attention to the chart [Medicare Reform Assumption Changes] showing the actuarial analysis done to redesign the medical plan under SB 141. The chart shows the claims costs for [fiscal year] 2004 at \$225 million of which 74 percent of these medical costs are incurred by retirees under age 65, and 26 percent for retirees age 65 and older.

[9:54:11 AM](#)

REPRESENTATIVE SEATON highlighted that the chart does not directly reflect the difference in costs for those [retirees] under age 65 and those over age 65. He opined that this difference would more accurately show possible savings to the state should the state find ways to dissuade members from early retirement.

[9:55:53 AM](#)

MS. MILLHORN, addressing an interest previously expressed by the committee, presented a one-page summary on the estimated contribution shortfall to PERS and TRS funds in FY 06 and FY 07.

She said that the \$385 million in Column D is the contribution amount based on the calculated rate for the categories listed in Column B: political subdivisions, school districts, state of Alaska, university, and other public organizations. In order to prevent adding additional liability to the system, she said, the actuary has calculated that "the contribution amount needs to be \$631 million for a shortfall in that contribution of \$245 million."

MS. MILLHORN explained that each year [the state] is not at the required contribution rate calculated by the actuary, a shortfall results, such as on June 30, 2004, when the shortfall for TRS was 1.24 percent for the employer contribution rate and .89 percent for PERS. "That has been the additional contribution amount and shortfall that is added to the system when [the state is] not at the actuarial rate," she said. Once the actuarial rate is reached, she explained, [the state] would pay at an amortized rate on a 25-year cycle.

[9:57:58 AM](#)

REPRESENTATIVE GRUENBERG, referring to Ms. Millhorn's mention of switching to an accrual method, inquired as to what effect this had on the shortfall figures and if "it caused a significant change and increase in the total deficit."

[9:58:16 AM](#)

MS. MILLHORN replied that in statute, there is a provision which requires that health care benefits be actuarially determined. She further explained that the State of Alaska, for PERS and TRS, "has always accrued for their benefits on an actuarial, accrued, liability basis and in fact they prefund." She said there are 11 other pension systems that prefund for medical costs, which she opined has been beneficial. In response to a question by Chair Weyhrauch, Ms. Millhorn said the expected contribution for FY 07 for the University of Alaska of \$38 million is derived from its payroll base, not from its submitted budget.

[9:59:52 AM](#)

CHAIR WEYHRAUCH asked if the actuarially required contribution of \$49 million for the university is the amount it would need to pay "so there's no shortfall." Upon hearing Ms. Millhorn's confirmation that this is accurate, he then asked, "What would be the problem, in terms of the system, by saying the

university's contribution should be \$49 million; that would be good for the system, right?"

MS. MILLHORN said the only caveat she would add is not being certain of the university's exact contribution because of 2 AAC 35.900 [from the Alaska State Administrative Code] which, until it's repealed, may cap the university's rate.

[10:00:57 AM](#)

REPRESENTATIVE SEATON said the 5 percent cap is what's causing the discrepancy.

CHAIR WEYHRAUCH expressed his belief that the [committee] needs to know what the legally required amount of the contribution is under the regulation and this component needs to be included. He said, "There's an artificial number here."

MS. MILLHORN agreed there is an artificial number [on the chart] for some employers but not all because PERS is based on the [employer's] own individual rate.

CHAIR WEYHRAUCH said he didn't know how to analyze the information on the chart in the context of the administrative restraints on the system.

MS. MILLHORN said she would use the chart by reviewing the employer's contribution amount for all categories, which in FY 07 is shown as a total of \$503 million and includes the required regulation rate for that employer.

[10:02:13 AM](#)

CHAIR WEYHRAUCH opined that this topic may "lead to the heart" of future discussions on the budget, and that [the committee's] efforts in making the system as whole as possible is subject to administrative constraints. He also posed the question as to what policy recommendations should be made "to the administration, or vice versa, on changing the caps that are in regulations so that the system can be made more whole."

[10:02:35 AM](#)

REPRESENTATIVE ROKEBERG stated his agreement with Chair Weyhrauch's comments and noted that the expected contribution of \$503 million is one sixth of [the state's] budget.

CHAIR WEYHRAUCH said, "So there's an expected contribution, a actuarially-required contribution, and then a legally-required contribution."

MS. MILLHORN said Chair Weyhrauch was correct and again stated that the expected contribution amounts shown in the chart reflect the regulations in place for those employers.

CHAIR WEYHRAUCH sought confirmation that the expected contribution amount assumes the legal requirement.

[10:03:29 AM](#)

MS. MILLHORN said this was correct with the exception of TRS, which although it has an adopted rate, has no legal requirement and no cap. She said 2 AAC 35.900 will be repealed going forward.

REPRESENTATIVE ROKEBERG referred to a discussion [the committee] had last fall as to whether the 5 percent cap was repealed by SB 141 and asked, "Then where are we?" He said, "Then it's a matter of what we budget in the [general funds ("GF")], too; it's a budgetary function additionally."

[10:04:12 AM](#)

REPRESENTATIVE SEATON expressed his opinion that the [committee] should recognize that the legislative cap of 5 percent does not really apply to TRS and has only been applied administratively. He said that although a collar on TRS is not required by statute, the underfunding of TRS by the recommended amounts is a policy decision, not a statutory [one].

REPRESENTATIVE ROKEBERG asked if it was accurate to say, in regard to the legal obligation, "that the budgetary appropriation can be whatever it is...we're not constrained to do something."

CHAIR WEYHRAUCH and MS. MILLHORN agreed that this was correct.

[HB 374 and HB 375 were held over.]

[10:05:15 AM](#)

**ADJOURNMENT**

There being no further business before the committee, the House Special Committee on Ways and Means meeting was adjourned at 10:05 a.m.