

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

March 24, 2006

9:03 a.m.

MEMBERS PRESENT

Representative Bruce Weyhrauch, Chair
Representative Ralph Samuels
Representative Paul Seaton
Representative Peggy Wilson
Representative Max Gruenberg
Representative Carl Moses

MEMBERS ABSENT

Representative Norman Rokeberg

COMMITTEE CALENDAR

OVERVIEW - ALASKA RETIREMENT MANAGEMENT BOARD RECOMMENDATIONS TO THE LEGISLATURE

- HEARD

PREVIOUS COMMITTEE ACTION

No previous action to record

WITNESS REGISTER

GAIL SCHUBERT, Chair

Alaska Retirement Management Board (ARMB)
Anchorage, Alaska

POSITION STATEMENT: Provided information and answered questions regarding the unfunded liability of the Public Employees' Retirement System (PERS) and Teachers' Retirement System (TRS).

LARRY SEMMENS, Board Member

Alaska Retirement Management Board (ARMB)
Kenai, Alaska

POSITION STATEMENT: Provided information and answered questions regarding one possible solution to addressing the unfunded liability of the Teachers' Retirement System (TRS).

DAVID SLISHINSKY, Principal and Consulting Actuary
Buck Consultants

Denver, Colorado

POSITION STATEMENT: Provided information and answered questions regarding the actuarial findings by Buck Consultants, the state's actuary for the Public Employees' Retirement System (PERS) and Teachers' Retirement System (TRS).

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

POSITION STATEMENT: Answered questions regarding the unfunded liability of the Public Employees' Retirement System (PERS) and Teachers' Retirement System (TRS).

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

POSITION STATEMENT: Answered questions regarding the unfunded liability of the Public Employees' Retirement System (PERS) and Teachers' Retirement System (TRS).

ACTION NARRATIVE

CHAIR BRUCE WEYHRAUCH called the House Special Committee on Ways and Means meeting to order at [9:03:06 AM](#). Representatives Weyhrauch, Moses, Seaton, and Wilson were present at the call to order. Representatives Gruenberg and Samuels arrived as the meeting was in progress.

OVERVIEW - ALASKA RETIREMENT MANAGEMENT BOARD RECOMMENDATIONS TO THE LEGISLATURE

[Includes brief mention of HB 238, HB 278, HB 375 and HB 492.]

[9:03:21 AM](#)

CHAIR WEYHRAUCH announced that the only order of business would be an overview provided by the Alaska Retirement Management Board (ARMB) with its recommendations to the legislature for addressing the unfunded liability of the Public Employees' Retirement System (PERS) and Teachers' Retirement System (TRS).

[9:04:08 AM](#)

GAIL SCHUBERT, Chair, Alaska Retirement Management Board (ARMB), as per the request of Chair Weyhrauch, introduced members of the

of the board to the committee: Gayle Harbo representing TRS; Sam Trivette representing PERS; Larry Semmens representing a municipal government; and Michael Williams, from Department of Revenue (DOR) in Anchorage, representing PERS. She also introduced others present with some affiliation to the board: Rob Johnson as outside legal counsel; Susan Taylor, from DOR, as staff to the ARMB; Melanie Millhorn from Department of Administration (DOA); Gary Bader, Chief Investment Officer for the ARMB; and Tom Boutin, Deputy Commissioner with DOR. She noted the three ARMB members not present at today's meeting: Commissioner William Corbus with DOR; Commissioner Scott Nordstrand with DOA; and Martin Pihl, the board's representation for the public. She added that with the resignation of Bob Roses of Anchorage, there is now a vacant position on the board.

[9:07:09 AM](#)

MS. SCHUBERT announced that the committee would be hearing a report from the actuary "that is not good news, unfortunately." She relayed:

The unfunded liability of PERS and TRS is significantly higher than it was this time last year. The unfunded liability of PERS is now \$4.4 billion and the unfunded liability of TRS is \$2.5 billion. The combined total is \$6.9 billion. When Mr. Bader previously testified before the committee, he stated that the ARMB had asked the actuary to estimate the amount of annual supplemental appropriations required to retire the unfunded liability using various amortization periods and capped contribution rates. We have received that data based upon the fiscal year 2004 (FY 04) valuation reports and expect to receive data for the FY 05 valuation shortly. One thing that is clear to the ARMB is that there is an actuarial cost to failing to address the unfunded liability. The board has considered a number of strategies to address the unfunded liability question. Among those strategies are pension obligation bonds which are addressed in HB 278, past service cost offset accounts in HB 238, retirement benefit liability accounts in HB 375 ... and this afternoon the board will also hear a report on using natural gas royalties.

It's the view of the board that we must begin to address the unfunded liability this year. The board is giving serious discussion to an approach that

borrowed ideas imbedded in some of the legislation previously mentioned, and combines them with some ideas of our own.

MS. SCHUBERT said that the board hopes to be back soon with more specific recommendations and that the committee would now hear from Larry Semmens on some of the concepts being considered by the ARMB for the TRS system.

[9:09:31 AM](#)

LARRY SEMMENS, Board Member, Alaska Retirement Management Board (ARMB), relayed that he is also the finance director for the City of Kenai. He informed the committee that the ARMB is considering a proposed solution to the TRS under funding problem that is patterned after the School Debt Reimbursement Program. He explained that this program is one in which the state has agreed to fund a certain percentage of outstanding school debt, an amount included every year in the state's budget. For TRS, an annual allocation to an employer would be required, he explained, that would be "based upon its qualifying payroll for two years earlier, the past service cost rate, and the amount appropriated by the state for past service retirement benefit liability program." He opined that this would produce a known, calculated amount every year. He reminded that committee that this pertains to TRS only. He then explained several benefits to this solution: it allows the ARMB to set the contribution rates at levels recommended by the actuary - rates currently markedly lower than recommended; it requires non-general revenue programs, such as federal programs, to pay the full cost; it enables the state to provide relief to all non-state employers with an unfunded retirement liability; it allows budgeting to be done with precision because the calculations would use historical data; it allows the legislature to make pro-rata payments should the legislature be unable to fully fund the program; and it creates a constituency for the program because of the statewide benefits it provides the communities. He then remarked that a similar solution is being considered for PERS, however, he noted that there are difficulties regarding this system's allocations. "TRS is simpler because everyone pays the same rate," he said.

[9:13:51 AM](#)

DAVID SLISHINSKY, Principal and Consulting Actuary, Buck Consultants, accompanied by the company's senior consultant, Michelle DeLang, informed the committee that an actuarial

evaluation for TRS and PERS was performed as of June 30, 2005, the results of which were presented at yesterday's meeting with the ARMB and to be presented again today at this meeting. He began by providing a brief overview of actuarial process, explaining that a set of actuarial assumptions is used in an attempt to predict the future benefit payment to be paid for both the pension and healthcare plans. He noted that as the new actuary for the state, one of Buck Consultants' tasks was to go through the actuarial evaluation performed by the state's former actuary, [Mercer Human Resource Consulting], with the intent to replicate those numbers produced by that actuary in its June 2004 valuation results. Additionally, Buck Consultants reviewed the assumptions and methods used by the former actuary for both PERS and TRS, one of which is the "projected unit credit method." He clarified that this method is one of six different actuarial cost methods approved by the Governmental Accounting Standards Board (GASB) for purposes of producing actuarial contribution rates and funded status amounts. However, he noted that this method is primarily used in the private versus public sector because the pattern of costs for members increases from date of hire until retirement. Most public plans use the "entry age method," he remarked, which produces a more stable cost derived from a percentage of pay from the date of hire until retirement. He said:

We found that the investment return assumption of 8.25 percent was reasonable given the current asset allocation policy of the ARMB. Payroll growth assumption ... was a little overstated, but we have not made any changes to any of the assumptions or the methods for the 2005 valuation. Generally the demographic assumptions were reasonable, but we are going to perform an experience analysis within the next couple of months ... to look in detail at the demographic assumptions to make sure that they're reasonable and closely match what the experience has been for both plans.

[9:18:21 AM](#)

CHAIR WEYHRAUCH inquired as to whether the demographic assumption includes longevity.

MR. SLISHINSKY agreed that it does in addition to other factors such as mortality, life expectancy, retirement patterns, withdrawal patterns, and disability. He went on to compare the former actuary's 2004 evaluation results to those determined by

Buck Consultants, [shown on slide 17 of the PowerPoint presentation], and noted that although some minor differences were found, none were significant because any increased liabilities were "washed out" by decreased liabilities. He noted, however, that significant differences were found with regard to the former actuary's valuation of the healthcare benefits for PERS. Buck Consulting determined that the accrued liability was [actually] 7 percent greater "than what Mercer reported in 2004." He added that with the higher accrued liabilities and higher cost rates for PERS, "the contribution rates that [Buck Consulting] would have come up with in 2004, would have been 30.37 percent of pay and not 28.19 percent of pay [as valued by the former actuary]. So, a little bit more than 2 percent of pay greater in the PERS system."

MR. SLISHINSKY directed the committee's attention to the 2005 actuarial valuation results and explained that the same process was used by Buck Consulting, [as was used for the 2004 determinations], to see if there were any changes. Furthermore, he noted that there were no changes to the benefit provisions, the actuarial assumptions, or any of the methodology. With these points in mind, he read the total actuarial value of assets for PERS, [listed on slide 21], from June 30, 2004 through June 30, 2005: beginning with \$8,030 billion, adding in the contributions, subtracting any disbursements made, and finally adding in the expected return on market value based on 8.25 percent. This preliminary actuarial value of [\$8.419] billion, he explained, is then adjusted by gains and losses for that year to equal the amount used for funding purposes: \$8,443 billion. He relayed that over the next four years, future smoothing amounts of approximately \$148 million still needs to be recognized.

MR. SLISHINSKY then turned the discussion to the history of the actuarial value, as opposed to the market value, shown in the graph on slide 22. He highlighted that during the 1990's, there was healthy growth in the assets, both in the actuarial and market values. He also provided information about the 2005 data being used in the evaluation [shown on the chart on slide 23]: 33,730 active members participating in PERS, combined with the fire and police departments [employees] and the 20,703 retirees resulting in a higher total of 73,299 [PERS members]. More of the data on the chart, he explained, covers the differences in market value and actuarial value assets, the annual benefit payments, and the accumulated member contributions.

MR. SLISHINSKY noted that in determining the actuarial contribution [as shown on slide 24], the amount of the accrued liability is calculated and totals \$12,845 billion in 2005 compared to \$11,444 billion in 2004. The resulting unfunded actuarial accrued liability for 2005, he announced, is \$4.4 billion, up from the \$3.4 billion the previous year. He also listed amounts for the funded ratio at 65.7 percent, the total annual actuarial contribution at 39.27 percent, the member contribution amount at approximately 6.8 percent of pay, and the employer required contribution of 32.43 percent - almost a \$100 million increase from the previous year. He relayed that slide 25 shows the degree to which the accrued liability and the normal cost is split between pension and healthcare.

[9:28:43 AM](#)

CHAIR WEYHRAUCH, referring to the amount of debt for PERS, TRS, and the total combined liability of \$6.9 billion, inquired as to how this compares to the judicial and military retirement systems.

MR. SLISHINSKY explained that the latter systems are small plans in comparison and their total combined liability would "not be much different than the \$6.9 billion." In further response to Chair Weyhrauch, he said that the chart [on slide 26] shows "the accrued liability ... [and] does not include the assets." He clarified that when calculating the unfunded liability, the assets are deducted from the [accrued liability]. This chart, he said, shows the relative distribution of the accrued liability between pension and healthcare and how it's changed over time. He opined that there has been a faster increase in the value of the accrued liability for the healthcare benefits versus the pension benefits and that by 2005, the healthcare benefits are over 40 percent of the total liability of the benefits. The final slide for PERS, he said, shows the funding ratio history.

MR. SLISHINSKY announced that he would now provide the committee with the results for TRS pension plans and noted that the actuarial value of assets in the year ending June 30, 2005 was approximately \$3.8 billion. Then, adding in the contributions of \$150 million, subtracting out benefit disbursements of \$359 million, and adding in the expected return on the market value of \$314 million, results in a preliminary actuarial value of almost \$4 billion, he said. He further noted that with the very small smoothing amount of \$9 million, the actuarial value is \$3,959 billion, and with the recognized gains at \$68 million,

the market value is \$4,027 billion. He then highlighted key points on the TRS data shown in a series of graphs similar to those used in featuring PERS data: asset smoothing comparisons of the market and actuarial values; pension and post employment healthcare figures for members, compensation, assets, annual benefit payments, and the accumulated member contributions up to an average of approximately \$50,000. He also noted that the actuarial accrued liability for TRS in 2005 has increased to almost \$6.5 billion and that the unfunded actuarial accrued liability, following deduction of the actuarial value of assets, is approximately \$2.5 billion. He also listed numbers for the funded ratio, the annual [actuarial contribution], member contributions, and the employer required contribution at \$236 million, or 42.14 percent of pay. He interpreted the graphs [on slides 34-36] noting the similarities and differences between the TRS and PERS data.

[9:37:24 AM](#)

MR. SLISHINSKY summarized:

There were modest gains on the market value experienced during the year: the rate of return was about 8.55 percent or .3 percent greater than what was assumed. There are still some gains that are being recognized from 2003 and 2004 and ... as a result, the actuarial value return was a little bit greater at 9.1 percent. So there were asset gains that acted to reduce the unfunded liability, and we'll see to what degree that is. There were losses on the liability due to decremental experience, and healthcare experience, and changes from the prior actuary primarily on [the PERS] piece.

CHAIR WEYHRAUCH inquired as to the meaning of "decremental experience."

MR. SLISHINSKY explained that it is the difference between what is expected and what actually happens due to such influences as life expectancy or deaths, patterns of retirement, the degree to which people terminate service, or salary changes. He returned to summarizing the unfunded liability for the retirement plans noting that the majority of losses and changes are on the healthcare side of the plans. He directed the committee's attention to the figures [on slide 38] which show the 2005 unfunded liability at \$4,402 billion for PERS and \$2,540 billion for TRS. In conclusion, he reviewed [slide 39] showing the

required employer contribution rates for PERS and TRS and the declining funded ratios.

[9:42:17 AM](#)

REPRESENTATIVE SEATON, regarding the PERS contribution of \$293 million shown on slide 21 relative to the normal cost of \$338 million shown on slide 24, sought confirmation to his understanding that the system is not contributing the "currently accruing liabilities" under the existing funding mechanism.

MR. SLISHINSKY said this is correct. He added:

That means that the actual contributions being made aren't meeting the actuarial rate. So, there is a contribution shortfall between what is being determined for purposes of funding the plan on an actuarial basis by paying the cost of the accruing benefits as well as amortizing the unfunded liability. To the extent that [the unfunded liability is not amortized], the liability will grow. It grows with interest and it grows with the cost of the accruing benefits to the extent that [should an amortization payment not be made] on that unfunded liability, it grows more and then it increases the amortization payment in the next year.

REPRESENTATIVE SEATON, regarding comparable data for TRS on slides 29 and 32, again sought confirmation to his understanding that [the state] is more than paying normal costs and accrued liabilities than what is being earned in 2005, as opposed to PERS where "we're still going backwards based on the currently accruing benefits."

[9:44:58 AM](#)

MR. SLISHINSKY provided a more detailed explanation of the data noting that the \$150 million contribution [for TRS] for the year ending 2005, should be compared to the 2004 annual contribution [shown on slide 32] with a normal cost of \$117 million and an amortization payment of \$146 million. He interpreted that the \$150 million is sufficient to pay for the cost of the accruing benefits, however, is does not sufficiently amortize the unfunded liability which is causing [the debt] to grow. With PERS, he explained that with the contribution of \$293 million and the normal cost of \$296, the former amount falls short by \$3 million of paying the normal cost. He indicated that "in that

situation over time, you would expect that the unfunded liability for the PERS would grow faster than for [TRS]."

CHAIR WEYHRAUCH, in noting the significant increase of the unfunded liability from \$5.7 billion last year to \$6.9 billion this year, asked how the state plans to address the debt.

[9:47:49 AM](#)

GARY BADER, Chief Investment Officer, Treasury Division, Department of Revenue (DOR), indicated his belief that he is not in a position to speak for the administration. He offered his understanding that it's the ARMB's intent to provide the legislature with suggestions to address the [unfunded liability of the state pension plans].

CHAIR WEYHRAUCH then asked Ms. Schubert when the ARMB plans to present its recommendations to the legislature.

MS. SCHUBERT indicated that the board hopes to report its recommendations to this committee in two to three weeks.

CHAIR WEYHRAUCH considered the [short] amount of time remaining in the session. He then referred to earlier testimony where "the biggest issue" discussed was an appropriation and that "the best way to deal with this might be just simply cash." He asked Ms. Schubert whether this solution had been considered by the ARMB.

MS. SCHUBERT explained that although this approach has been considered by the ARMB, a consensus has not been reached.

CHAIR WEYHRAUCH, in expressing his understanding that the board's deliberations were not confidential, he asked what possible actions have been discussed by the ARMB.

[9:49:50 AM](#)

MR. BADER expressed his belief that the ARMB would perhaps first want to hear the presentation this afternoon, regarding [the possibility of using] the natural [gas] resource asset, prior to putting forth recommendations to the legislature. He opined that although the suggestions made earlier by Mr. Semmens allow an approach that has "traction among board members," the ARMB needs more time to consider the options.

CHAIR WEYHRAUCH noted that "significant problems" were identified regarding the proposed legislation, [HB 492] - the primary one being the transfer of gas assets to the ARMB. He opined that this legislation may have to be substantially amended to not only meet constitutional requirements but to add value to addressing the unfunded liability. He said, "I was a promoter of that bill in concept, so just don't hang your hat too high on that bill."

[9:51:50 AM](#)

REPRESENTATIVE WILSON expressed that her main concern and interest pertains to the unfunded liability and should it not be addressed within the next 10 years, would it become "huge or small."

MR. BADER said "huge."

[9:52:48 AM](#)

TOM BOUTIN, Deputy Commissioner, Treasury Division, Department of Revenue (DOR), expressed his belief that although the unfunded liability has continued to grow since it was discussed during the 2002 transition in the administration, it is not an [unexpected] revelation. Each year, he noted, the actuary tells the employers the amount needed to amortize the unfunded liability over 25 years, and that it is "obvious" to him that the debt has continued to grow when the recommended employer rate has not been paid.

[9:54:55 AM](#)

REPRESENTATIVE SEATON said it was his understanding that none of the employers have seen any contribution rate increases. He expressed his interest in hearing suggestions from the ARMB on how to approach the employers regarding increasing payments to reduce the pension debt.

[9:56:13 AM](#)

MR. BOUTIN informed the committee that the ARMB did adopt higher contribution rates at its first meeting.

MS. SCHUBERT relayed her belief that the [employer] rate [the ARMB] adopted for PERS was 21 percent and 26 percent for TRS. She deferred to Mr. Semmens for confirmation of this.

CHAIR WEYHRAUCH interjected that [the legislature] "would want [the ARMB] to be as scathingly honest and objective as [it] possibly can and let political chips fall where they may." He opined that it is very important for the public and the legislature to understand the fundamental problem with the [state retirement] system and what measures are needed to fix the problem.

MS. SCHUBERT expressed her belief that the ARMB is cognizant of this and intends to make [any] necessary recommendations.

[9:57:57 AM](#)

MR. SEMMENS relayed his belief that both TRS and PERS are in the third round of rate increases with the first round of 5 percent taken from the employers' resources. The second 5 percent, he said, "came out with help from the state." He expressed that he was "glad to hear ... that there's 10 percent available in the budget for next year" and conveyed his hope that this amount is approved [by the legislature]. He said that since the state is expected to have a large budget surplus this year, the ARMB recommends that the legislature make contributions to the systems "in order to increase the funding ratio."

CHAIR WEYHRAUCH opined that this was "too qualitative." He then announced the presence of Commissioner William Corbus, DOR, for the majority of the meeting.

[9:58:59 AM](#)

REPRESENTATIVE SEATON said he hoped that the ARMB would find a mechanism by which those communities that applied last year's 5 percent, of funded employer contributions, toward retiring their unfunded liabilities, are recognized for this rather than penalized.

[10:00:13 AM](#)

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Ways and Means meeting was adjourned at 10:00 a.m.