

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

April 18, 2006

8:32 a.m.

MEMBERS PRESENT

Representative Bruce Weyhrauch, Chair
Representative Ralph Samuels
Representative Max Gruenberg
Representative Carl Moses

MEMBERS ABSENT

Representative Norman Rokeberg
Representative Paul Seaton
Representative Peggy Wilson

OTHER LEGISLATORS PRESENT

Representative Kurt Olson

COMMITTEE CALENDAR

ALASKA RETIREMENT MANAGEMENT BOARD PRESENTATION -
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 a brief overview of the
background, purpose, and goals of the ARMB.

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

POSITION STATEMENT: Provided background information and answered questions on those recommendations and strategies considered by the ARMB.

REPRESENTATIVE DAVID GUTTENBERG

Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: Asked questions and voiced concern on the effect of rising healthcare costs to the Public Employees' Retirement System (PERS) and Teachers' Retirement System (TRS).

LARRY SEMMENS, Board Member

Alaska Retirement Management Board (ARMB)
Kenai, Alaska

POSITION STATEMENT: Presented the ARMB recommended solutions for addressing the unfunded liability of the Public Employees' Retirement System (PERS) and Teachers' Retirement System (TRS).

MARTIN PIHL, Member

Alaska Retirement Management Board (ARMB)
Ketchikan, Alaska

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

WILLIAM A. CORBUS, Commissioner

Department of Revenue (DOR)
Juneau, Alaska

POSITION STATEMENT: Answered questions regarding other possible funding sources to address the Public Employees' Retirement System (PERS) and Teachers' Retirement System (TRS).

SAM TRIVETTE, Vice Chair

Alaska Retirement Management Board (ARMB)
Juneau, Alaska

POSITION STATEMENT: Testified in support of the recommendations made by the ARMB.

ACTION NARRATIVE

CHAIR BRUCE WEYHRAUCH called the House Special Committee on Ways and Means meeting to order at 8:32:58 AM. Representatives Weyhrauch and Moses were present at the call to order. Representatives Gruenberg and Samuels arrived as the meeting was in progress. Representative Olson was also in attendance.

[Includes brief mention of SB 141, HB 278, HB 492, HB 238, HB 375, SB 247, and HB 475.]

[8:33:08 AM](#)

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

[8:34:38 AM](#)

GAIL SCHUBERT, Chair, Alaska Retirement Management Board (ARMB), began by providing the committee with a brief overview, noting that the ARMB was established in October 2005 as a result of the passage of SB 141. She highlighted that one of the important provisions of SB 141 directed the ARMB to prepare a report to the legislature with short-term and long-term recommendations to address the unfunded liability of PERS and TRS. She relayed that many of the recommendations made in the report, presented in January 2006, are already underway in the Division of Retirement and Benefits, Department of Administration (DOA). She explained that the legislature was informed that it is the ARMB's goal to identify funding strategies to fully fund the retirement obligations to the state's public employees "with minimal impact to the services to the residents of Alaska." She reminded the committee of the March 2006 presentation it heard from the board's actuary at which time it was relayed that the combined unfunded liability of PERS and TRS has grown to \$6.9 billion. She opined that the process of "digging out [of debt] will not be pleasant," however, "delaying action will only make things worse." She requested that Gary Bader, with Department of Revenue (DOR), provide the committee with background information on the process that led to the recommendations, followed by a detailed explanation of those recommendations given by Larry Semmens, a member of the ARMB.

[8:37:25 AM](#)

GARY BADER, Chief Investment Officer, Treasury Division, Department of Revenue (DOR), informed the committee that a slide presentation was prepared to provide background information on those strategies considered [in addressing the debt of the state

retirement systems]: large dollar strategies, incremental strategies, investment returns, and extending the amortization period. Regarding the use of pension obligation bonds as one possible large dollar strategy, he said that although the ARMB currently has no recommendation on this strategy, it has not been ruled out.

CHAIR WEYHRAUCH interjected to question the meaning of slide 4 which read:

HB 278 does not authorize any debt instruments to be issued. The state or a municipality would need to take a separate action to utilize this new ability of the Municipal Bond Bank Authority.

MR. BADER confirmed that should HB 278 pass, it would provide a new ability of the Municipal Bond Bank Authority. However, he clarified that although it could be an option for a political subdivision, the ARMB is not proposing it as a strategy for addressing the unfunded liability. In further response to Chair Weyhrauch, he stated his understanding that the authorization of any debt instruments would [first] require action by the Municipal Bond Bank Authority. He then noted a second large dollar strategy considered by the ARMB: the deposit of a large natural resource asset of natural gas leases as proposed in HB 492. He said that constitutional, valuation, and cash flow issues with this legislation would need to be addressed before this could be considered a viable solution. Regarding possible incremental strategies, he relayed that the Past Service Cost Offset Account (PSCOA), as proposed in HB 238, is a possible means of providing a systematic, long-term solution to assist communities and employers with their growing unfunded liability payments by cutting the cost of contributions approximately 56 percent over a 25-year amortization period. He briefly conveyed other possible incremental strategies as proposed in HB 375, HB 376, and SB 247. In noting that the rates set by ARMB for this year, incremented by 5 percent, still does not match the actuarial computed rate required to fully fund the system in 25 years, he explained that SB 247 would bridge the gap between these rates through means of an underfunded liability relief account.

MR. BADER then addressed investment returns as shown in the chart on slide 8. He highlighted that the state is now experiencing higher rates of return: approximately 15 percent in fiscal year 2004 (FY 04), 8.95 percent in FY 05, and 14.44 percent calculated through December [2006]. He explained that

the table shown on slide 9 entitled, "Extend Amortization Period," is designed to show what the required supplemental contributions would be according to the different amortization periods and employer contribution rates selected and keeping the normal cost rate and the average member contribution rates constant.

[8:47:07 AM](#)

MR. BADER, in response to Chair Weyhrauch, provided an example of one possible scenario: an employer rate of 21 percent, during a 30-year amortization period with a 6.84 percent average member contribution rate would result in the state having to supply another \$150 million to the system in order to be fully funded in 30 years. "So the 21 percent by itself isn't enough. It would require an additional increment," he said.

CHAIR WEYHRAUCH inquired as to whether "dealing with the amortization period" requires a legislative or administrative action.

MR. BADER explained that currently the amortization period is determined by the ARMB. He noted that one of the sections in HB 475 proposes to "essentially set the amortization rate at 30 years" and that should the legislature want to adopt a 40-year amortization period, it would be in conflict with the timeframe proposed in HB 475. In further response to Chair Weyhrauch, he confirmed that any one of the funding scenarios shown in the table on slide 9 would require some [supplemental contribution] from either the legislature or the employers. He opined "that this is a useful table in terms of shaping the size of the problem" and providing an array of options. He highlighted that the table in slide 10 aims to provide a similar array of options for TRS. He then informed the committee of some of the suggestions made to improve the financial health of the plans: offer no enhancements to PERS and TRS benefits for at least two years; to index the health deductible in the new plan; and to create a new retirement health plan for new members.

CHAIR WEYHRAUCH, regarding the mention of a two-year period of no enhancements to the plans, questioned whether this was an adequate amount of time. He suggested that perhaps it actually should be "an indefinite no enhancement."

MR. BADER said he agreed and stated his belief that ARMB did not want to be too presumptuous with what it considers to be a prerogative of the legislature.

CHAIR WEYHRAUCH opined that the "legislature needs to get [its] mind around the problem" which could extend far beyond a two-year period unless [the state] substantially appropriates funds.

MR. BADER again said he agreed. He then returned to addressing the recommendations made by the ARMB and confirmed the observation made by Chair Weyhrauch that some of these recommendations and issues are currently being addressed by the executive branch and therefore do not require involvement by the legislature at this time.

[8:53:21 AM](#)

REPRESENTATIVE DAVID GUTTENBERG, Alaska State Legislature, inquired as to whether the ARMB has "worked on any estimates [on] incremental changes to either the preferred provider programs ... or the negotiated drug prices we do."

MR. BADER explained that the ARMB has not specifically done this and deferred to the Division of Retirement and Benefits which has. He relayed that the ARMB has largely focused on the financial aspects and not the programmatic ones. He then concluded his presentation by listing the ARMB goals: full funding within 30 years; no severe disruption in public services; the state's participation in the solutions; rewarding accelerated contributions from employers; ensuring equitable state support; and minimizing the supplanting of federal funds and other non-general fund costs. "So given these objectives, the board went about crafting a number of possible solutions," he said, which would be addressed by Mr. Semmens.

[8:55:58 AM](#)

LARRY SEMMENS, Board Member, Alaska Retirement Management Board (ARMB), directed the committee's attention to page 13 of the report in their packets dated April 14, 2006, entitled, "Alaska Retirement Management Board - Final Report to the Legislature" and paraphrased the following introduction:

The board acknowledges that it is late in the legislative session for consideration of additional appropriation legislation, and appreciates the endeavors of legislators, committees, and staff to address the unfunded liability. However, it is in the best interest of the retirement systems for the legislature to address the under funding of the

systems in both the fiscal year 2007 and 2008 budget process, or the unfunded liability will very likely grow larger. The board offers the following recommendations, listed by priority for action by the legislature. These recommendations, both short- and long-term, address employer concerns with escalating contribution rates and the growing actuarial shortfall of the retirement systems.

MR. SEMMENS explained that "Priority 1" establishes a past service retirement liability account for both PERS and TRS. He then listed the particulars for the PERS fund: an account is established; a method to annually calculate a specific amount to be included in the governor's budget is provided; is applicable to political subdivisions and school district employer members of PERS; provides incentives for employers to pay down their unfunded liability; and anticipates that the ARMB would set the employer contribution rate at the actuarially required rate. He noted that for the FY 07 budget, the ARMB set the rate five points above the prior year rate - not the actuarially required rate - which means the system will be underfunded unless further contributions are made. He further clarified that if the system is to be fully funded, this requires the employers pay the lower of the average past service cost rate or their own past service cost rate less 5 percent. This means, he said, that the most the state would contribute to an employer, is the average past service rate of all employers. He explained that incentives would be included for those employers that paid in excess during the fiscal year three years earlier.

MR. SEMMENS then listed the particulars for the TRS fund on page 14 of the report: establish a past service liability account; provide a method to calculate a specific amount to be included in the governor's budget; applicable to all TRS employers; and, as with the PERS fund, anticipates that the ARMB would set the employer contribution rate at the actuarially required rate which exceeds 42 percent this year. The difference between TRS and PERS, he noted, is that with the former, the calculated amount for distribution would be based on 85 percent of the total eligible payroll that the employer reported to [DOR] during the fiscal year three years earlier, in order to capture the full cost of those federally funded programs that school districts have.

MR. SEMMENS went on to explain "Priority 2" on page 14 of the report. He highlighted that in 2005, the legislature

appropriated approximately \$17 million of "PERS aid" to municipalities. He informed the committee that the ARMB recommends an appropriation be made this year as well yet require the employers share the increasing PERS costs with the state, 50:50, with a 5 percent increase. He expressed his belief that municipal employers "would very much appreciate the legislature repeating the PERS aid program that was done for FY 06." He then explained that "Priority 3" recommends "the legislature appropriate funds to meet the actuarially required amount to fully fund the system this year." He clarified that the intent of this priority is not to have the assets equal the liabilities but rather focuses on the point that should the legislature or employers not contribute the amounts required by the ARMB's rates, then the system will most likely fall further behind. More specifically, he identified that the actuarially required amount for PERS is \$461 million and [yet] the projected actual contribution, using the adjusted employer rates, is \$351 million - a difference of \$110 million. With TRS, he noted that the actuarially required amount is \$261 million, and [yet] the actual projected contribution is \$163 million - a difference of \$98 million. He reiterated that it is the ARMB's recommendation that the state provide funding for [these differences]. He concluded, "We understand these are large numbers, that this is late in the session, but we feel that it is important for us to communicate to you the magnitude of the shortfall."

[9:05:38 AM](#)

CHAIR WEYHRAUCH conveyed some of the comments he has heard [regarding the unfunded liability] such as, "Well, we don't have to pay this now, so it's really not a big problem; it's a future problem."

MR. SEMMENS said that whereas this is an accurate statement, the problem remains if the debt is not paid now. He compared it to a home mortgage: if the debt is paid early, much will be saved in not paying interest for the life of the loan.

CHAIR WEYHRAUCH provided an example of another comment made by some [legislators] who feel the issue is not a concern for them because so few of their constituents are in professions which PERS and TRS benefit: teachers and government employees.

MR. SEMMENS said this is incorrect, that "it does not benefit teachers or public employees because those benefits are guaranteed by the state constitution." He opined, "What this really benefits is the people of Alaska by reducing the amount

of money that they would pay over time." He expressed his belief that this time of surplus is an ideal time to pay off the debt and will save Alaskans money. In further response to Chair Weyhrauch, he said that public services would soon be affected [by the debt] and that services and taxes will be affected with any increase to employers' PERS rates. He further clarified that whereas the retirement reform passed last year does impact the growth of future liabilities, it does not pay off the unfunded liability of the past. Regarding the belief held by some that should [oil tax] legislation be adopted, it will [sufficiently] address the unfunded liability of PERS and TRS, he opined that it might make it easier, however, funding the systems has to be done at the levels recommended by the ARMB - "\$150 million a year."

REPRESENTATIVE DAVID GUTTENBERG, Alaska State Legislature, inquired as to whether the passage of SB 141 has either affected the loss of employees from or into the system, and whether new liabilities have resulted from this.

MR. SEMMENS remarked that should there be no new employees coming into the system, it would have the effect of raising the rates that each public employer would be required to pay. However, he said he did not expect the numbers to decline as a result of SB 141. He opined that "the fix in HB 475, would make it clear that the payroll upon which the past service liability rate would apply, is on the total employee base, including Tier IV and all prior years."

[9:11:40 AM](#)

CHAIR WEYHRAUCH confirmed that Martin Pihl, next to testify, was appointed by the governor to the ARMB, represented the private sector, was retired from work with his own private pension plan, and has never been a public employee. He then asked Mr. Pihl for his opinion on the status of PERS and TRS and on the recommendations made by the ARMB.

[9:12:12 AM](#)

MARTIN PIHL, Member, Alaska Retirement Management Board (ARMB), expressed his belief that the debt would be handled quite differently if it were "corporate America." He opined that although misled by actuaries, the state is responsible for the current status of the pension plans and that benefits were established without realizing the price tag. Furthermore, he offered his belief that addressing the debt should not be

delayed, that [the state] has a cash flow problem, and that he likes "the idea of a possible fix through a few gas wells."

CHAIR WEYHRAUCH stated his agreement with Mr. Pihl on the possibility of using future gas assets to help fund the systems as being a good idea.

REPRESENTATIVE GRUENBERG asked Mr. Pihl to clarify his comment regarding the state being misled by actuaries.

MR. PIHL stated his understanding that the legislature was told [by the actuaries] that an increase to benefits could be done without increasing contribution rates. He opined that "you don't get to \$6.9 billion without a combination of a lot of mistakes" and that "actuarial work using national data for Alaska doesn't work."

REPRESENTATIVE GRUENBERG expressed his concern regarding statutes of limitations.

CHAIR WEYHRAUCH said that with no representation present from the attorney general's office, he would defer this topic to legal counsel.

[9:18:08 AM](#)

REPRESENTATIVE GUTTENBERG expressed his thanks to the ARMB for its work on the report. He opined that there were both "good and bad" results from passage of SB 141. In noting that the ARMB's recommendations largely address financial ways to address the debt, he expressed his wish that the board take a more aggressive stand on addressing rising healthcare costs. "It's out of control and it's completely inconsistent," he opined.

MR. SEMMENS informed the committee that the ARMB does have a health committee which is looking at ways to control healthcare costs.

CHAIR WEYHRAUCH expressed his belief that healthcare cost management "is probably the biggest problem associated with most of these national problems, not just Alaska's, so we're going to have to deal with that in a global manner." He then asked the ARMB to relay which of its recommendation the board feels the state should address first.

MR. SEMMENS informed the committee that the top priority is articulated in "Priority 1," the long-term solutions. In

response to Chair Weyhrauch, he confirmed that this priority recommends establishing past-service liability accounts as well as a "method for funding them and getting those dollars in the next [FY 08] budget cycle."

CHAIR WEYHRAUCH sought confirmation of his understanding that the top priority not only recommends establishing the accounts but also involves appropriating money.

MR. SEMMENS said this is correct and deferred to Mr. Bader for more detail.

MR. BADER clarified that although this first priority addresses establishing the mechanism, the funding would not begin until the 2008 budget.

CHAIR WEYHRAUCH asked Commissioner Corbus whether there was any creative way to fund the liability without general fund appropriation or through taxes.

[9:23:50 AM](#)

WILLIAM A. CORBUS, Commissioner, Department of Revenue (DOR), offered his understanding that there was no such mechanism.

CHAIR WEYHRAUCH inquired as to whether there was any "specific pool of money" that could be accessed to address the appropriation issue.

COMMISSIONER CORBUS said he was not aware of any and opined that "the appropriate place is the general fund."

REPRESENTATIVE GRUENBERG called the committee's attention to the proposed legislation in "Appendix 1" and "Appendix 2" of the ARMB report. He said he would like to make a conceptual motion that would "get the ball rolling" in this committee to introduce similar legislation.

CHAIR WEYHRAUCH clarified that as special committee, there are no existing rules permitting the House Special Committee on Ways and Means to introduce legislation. He said this could be done through a standing committee.

[9:25:48 AM](#)

SAM TRIVETTE, Vice Chair, Alaska Retirement Management Board (ARMB), relayed that he did participate in the work of the ARMB

and opined that [the report] offers the best effort at this time. He shared that "unfortunately [the ARMB] found out in [its] latest actuarial report, there were other mistakes made by the previous actuary that just came to light last month ... and [will attempt to ensure] that it doesn't happen again."

MS. SCHUBERT expressed thanks on behalf of the ARMB for the [legislature's] input in the process of solving the [unfunded liability of PERS and TRS].

[9:27:02 AM](#)

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Ways and Means meeting was adjourned at 9:27 a.m.