

MINUTES
SENATE FINANCE COMMITTEE
January 26, 2005
9:32 a.m.

CALL TO ORDER

Co-Chair Green convened the meeting at approximately [9:32:58 AM](#).

PRESENT

Senator Lyda Green, Co-Chair
Senator Gary Wilken, Co-Chair
Senator Con Bunde, Vice-Chair
Senator Fred Dyson
Senator Bert Stedman
Senator Donny Olson

Also Attending: SENATOR GARY STEVENS; REPRESENTATIVE MIKE KELLY; MELANIE MILLHORN, Director, Division of Retirement and Benefits, Department of Administration;

Attending via Teleconference: From an offnet location: BOB REYNOLDS, Senior Actuarial Consultant, Mercer Human Resource Consulting

SUMMARY INFORMATION

Overview By Department of Administration:
Public Employee's and Teachers Retirement Systems

AT EASE [9:35:42 AM](#)

MELANIE MILLHORN, Director, Division of Retirement and Benefits, Department of Administration, directed her testimony to a handout titled, "State of Alaska, PERS & TRS, Presentation to the Alaska Legislature" [copy on file.]

Ms. Millhorn indicated the three funding policies that govern the Public Employee's Retirement System (PERS) and the Teacher's Retirement System (TRS), as demonstrated on page 2 of the overview. The Alaska State Pension Investment Board governs the investment policy. The Funding policies are administered by the Public Employee's Retirement Board, which also has the authority to set the employer contribution rate. The Teacher's Retirement Board has

the authority to make a recommendation to the commissioner of the Department of Administration for the employer contribution rate.

Ms. Millhorn noted that over the past several years, the Teacher's Retirement Board had actually adopted and implemented the employer contribution rate. This came to the attention of Commissioner Ray Matiashowski, who then reminded the TRS Board that it did not have that authority and the practice has ceased.

Ms. Millhorn informed that some funding policies governed by the PERS Board, the TRS Board and the commissioner include "experience studies" conducted on the boards every four to five years. Actuarial audits are done approximately every five years. This information is available on the Internet.

Ms. Millhorn stressed that the legislature has the "unfettered right" to determine the benefits policy for the retirement systems. In 1978 the State attorney general issued an opinion finding that retirement benefits could not be negotiated through the collective bargaining process. This decision has not been challenged.

Senator Dyson clarified that the legislature has the authority to determine benefit policy for the future, but could not make changes retroactively.

Ms. Millhorn affirmed the legislature could only establish new tier levels.

Ms. Millhorn characterized page 3, "Alaska Public Employees' and Teachers' Retirement System, Earnings-Actuarial Rate-Health Cost-Employer Rates-Funding Ratios" as a summary sheet. The PERS and TRS systems are defined benefit plans in that the benefits paid are based on a formula established in statute. Members receive a lifetime benefit that is based on years of service, salary and age. Actuarial evaluation reports are prepared annually on the PERS and TRS programs and measure the assets and the liabilities of the plan. One primary function of an actuarial evaluation is to determine the annual contribution amount that is expected to adequately provide for future benefit payouts. There are over 20 separate assumptions that divided into demographic assumptions and economic assumptions. Two of the major economic assumptions are the investment return and the health cost trend. An actuarial evaluation is essentially a "snapshot in time" to demonstrate what is necessary in the event all benefits must be paid out at one point in time. She qualified this would never occur, but the information is necessary to determine the solvency of the system.

Ms. Millhorn noted the measurement years of FY 01 through FY 03,

and employer rate years of FY 04 through FY 06, listed on page 3. The employer contribution rate is set two years ahead. The actual investment return for FY 01 and FY 02 were negative and the return for FY 03 was a positive rate of 3.69 percent. The system is projected over a 25-year period at a targeted rate of 8.25 percent. The shortfall over this three-year period is represented on the summary as a percentage and as a dollar amount.

Ms. Millhorn reported that historically employer and employee contributions comprise of 25 percent of the total contributions and that 75 percent is derived from investment returns on the Fund. The health care cost is another primary economic assumption and was 7.5 percent in FY 01. This assumption was reset beginning in FY 02 to twelve percent. The consequence of this was "that it took in considerable liability to the System by changing that health trend cost upward." However it more accurately reflects the actual experience that has occurred for the systems over "some period of time."

Ms. Millhorn stated that the total accrued liability from the "health care percent" was 30 percent for FY 01 and 40 percent in FY 03. This is fairly significant to the PERS systems. The same liability to the TRS system is 28 percent.

Ms. Millhorn explained that the average calculated rate is determined by the consultant, Mercer Human Resources Consulting, and presented to the boards with a recommendation of what the contribution rate must be to fund future benefits for members. The average calculated rate for the PERS system was 25.63 percent. The PERS Board is allowed by regulation AAC 35.900 to adopt up to a five percent increase or decrease in a one-year period. The PERS Board adopted this regulation in 1991 at the request of the Municipality of Anchorage for budgetary purposes.

9:45:17 AM

Ms. Millhorn reminded that, unlike other pension systems, the PERS and TRS plans pre-fund for medical benefits. The funding ratio of the plans calculated without medical costs is 121.4 percent; calculated with the medical liability component, the funding ratio is 72.8 percent. The states of Ohio, Michigan and Kentucky are the only other states that pre-fund for medical benefits.

Senator Stedman asked if the calculation of the funding ratio excluding the medical liability included all the assets in the plan.

Ms. Millhorn answered yes.

Senator Stedman noted that a portion of the contributions are "embedded" for health care costs.

Ms. Millhorn deferred to Mercer Human Resource Consulting.

BOB REYNOLDS, Senior Actuarial Consultant, Mercer Human Resource Consulting, testified via teleconference from an offnet location to reaffirm that the 121 percent funding ratio for non-medical benefits includes all the assets of the PERS system. He also affirmed Senator Stedman's observation that the ratio is as high as it is because the systems have been funding to target both medical and non-medical benefits over time. Mr. Reynolds qualified that if the contributions had only been targeted to fund non-medical benefits, the funding ratio would be considerably lower.

Senator Stedman clarified that if the systems had never been funded to pre-fund medical costs, contribution rates would have been much lower and the 121 percent funding ratio would also be lower.

Mr. Reynolds affirmed.

Senator Stedman surmised that Alaska's systems are therefore not readily comparable to the systems of other states that do not pre-fund for medical benefits.

Mr. Reynolds agreed; although in terms of comparing the liabilities and the assets of the system this is a good comparison. The funding ratio is determined by dividing the assets by the non-medical liabilities.

Senator Stedman clarified that the Board-adopted contribution rate for FY01 was 6.77 percent and was 16.77 percent for FY 03. He asked if this increase was "substantially broader" compared to other states. He asked if the contribution rates for other states had been "extremely low".

Mr. Reynolds did not have specific survey data on the matter, but estimated Senator Stedman's assessment was correct. The standard actuarial practice is to calculate a contribution rate that takes into account the funded status of the system. At a time when the funded status of a system is in excess of 100 percent, the surplus could be drawn upon to lower contribution rates. Many, if not most, systems had a perceived surplus during the later 1990s prior to market losses and changes in assumptions to reflect health care experience.

Senator Stedman characterized the over-funding of the Alaska

pension systems that occurred in 1999 and 2000 as "slight" at approximately one to five-percent, rather than a more significant 20 percent.

Mr. Reynolds cited the consultant's evaluation reports finding that the funding statuses not significantly in excess of 100 percent. One reason is the use of "smoothing practices" in valuing the assets of the system to mitigate some of the volatility inherent in the investment market. Actual funding status relative to the market value of the assets would have demonstrated a higher over-funding of between 115 and 120 percent. The adjusted funding status factoring the smoothing practices calculates the funding status at between 101 and 106 percent.

Senator Stedman asked for explanation of how the smoothing practice operates: its benefits as well as the possibility of "skewing" results.

Mr. Reynolds remarked that smoothing is a standard actuarial tool. It is done in an attempt to help the State and the boards to budget for the contributions to the plans. The contribution requirements are a function of the funded status of the systems, which is the difference between the liabilities and the assets of the systems. The assets are diversely invested in the marketplace by the Alaska State Pension Investment Board, according to investment policy, and include stocks, bonds and real estate. Those investments measured over short time periods of one year can be volatile. The theory of smoothing methods is to help mitigate that volatility to allow for "a more orderly" funding process. Over longer time periods, this theory is successful. However, the situation was different in recent years because of several consecutive years of significantly higher than expected rates of returns followed by three successive years with significantly lower rates of returns than expectations.

Senator Bunde noted that the average calculated rate for the PERS and TRS plans were significantly higher than the contribution rates adopted by the boards.

Ms. Millhorn defined the average calculated rate as the contribution rate recommended by the consultant to the boards as necessary to fully fund the plans. She explained that the adopted rates are lower because the PERS board is limited by regulation to a five percent annual increase or decrease. The TRS Board is not limited by such a cap, and could have adopted a higher percentage rate increase.

Senator Bunde understood that the PERS Board adopted the maximum increase allowed, and the TRS Board could have adopted a higher

rate increase, but chose not to.

Ms. Millhorn affirmed.

Senator Bunde commented to this action of "not facing reality".

Ms. Millhorn indicated this would be discussed.

Ms. Millhorn spoke of the consequences of the boards' adoption of rates lower than the recommended average calculated rates. The systems incur additional liability for the next 25-year period. This represents an additional liability of 1.4 percent for PERS and 1.1 percent to the employer contribution rate.

Senator Bunde was interested in why the boards failed to adopt the recommended rate. He surmised this "makes the problem worse not better."

Ms. Millhorn agreed. She acknowledged the "flip side" from the employers' perspective of the amount of increases an employer could budget for in any one year.

Ms. Millhorn continued with her presentation noting the information listed for the PERS plan is also listed for the TRS plan on page 3. The situation of TRS is similar to that for PERS. The projected investment return is 8.25 percent, although the actual returns were 3.68 percent for FY 03, compared to 3.67 percent for the PERS plan. The cumulative shortfall for TRS during the three-year period of FY 01 through FY 03 is 34 percent and represents a shortfall to the system of \$2.1 billion.

Ms. Millhorn noted the cumulative health care trend was changed during this time period and represents 28 percent in accrued liabilities to the TRS plan and 40 percent to the PERS plan. The benefit is higher for TRS members at approximately \$2,500 per month per member compared to the average benefit of approximately \$1,500 for PERS members.

Ms. Millhorn reported that the TRS system is funded at 89.5 percent excluding the medical liability. Including the medical component, the system is funded at 64.3 percent.

Senator Stedman requested further information be provided to him regarding the funding ratio, specifically the impact of the smoothing practices.

Ms. Millhorn would provide this information.

Co-Chair Wilken noted the funding ratio is calculated as a total and with the medical benefits excluded. He assumed that the medical benefits and non-medical benefits funding ratios would calculate to the total. He asked the funding ratio of the medical benefits excluding the non-medical benefits.

Ms. Millhorn deferred to Mr. Reynolds.

Mr. Reynolds replied that because all assets have been applied to the calculation of non-medical benefits, the medical benefits would have zero assets.

Senator Stedman commented that the data could be calculated to show all the assets for either medical or non-medical benefits, and therefore the analysis is meaningless because the assets are "double-counted".

Ms. Millhorn next directed attention to page 4, a press release from Gallagher Benefit Services, Inc. titled, "New GASB Rules for Public Sector Plans Finalized". This announces that in November 2004, the Government Accounting Standards Board (GASB) released a Technical Bulletin mandating that by the year 2007, employers subject to GASB rules account for retiree health benefits in defined benefit pension plans. Most pension systems currently make annual appropriations for medical benefits expenses. This will have no affect on the Alaska systems because they already pre-fund for medical benefits. It will have a significant impact on other pension systems.

Senator Stedman emphasized that the position of Alaska's pension plan is different than that of the state of California or other states that currently do not pre-fund medical benefits. Alaska's unfunded liability is considerably "smaller and easier to handle" than other states.

Ms. Millhorn agreed that because the Alaskan plan accounts for liabilities on pension and medical benefits on an accrual basis, it is better prepared than other systems. In 2007 those other systems would be required to account for medical liabilities. This is significant and could affect the bond ratings for those states. Officials are attempting to "cut those costs any way that they can."

Mr. Reynolds had only anecdotal data on the size of the other states' pension plan medical liabilities. The new GASB rules would not require those systems to pre-fund for medical benefits, only to account for the liability. However the discount rate on the assumed rate of return that governmental entities utilize to calculate

liabilities is supposed to be based on the assets held toward those liabilities. The PERS and TRS systems utilize a return assumption of 8.25 percent, based on the investment policy of the ASPIB board for pre-funding medical benefits. According to the new GASB rule, states that do not pre-fund for liabilities must utilize the internal rate of return, essentially a cash rate, to value those liabilities. This could be approximately three-percent. Not only would these plans "be booking a liability for the first time" but would also be required to state a liability that is considerably higher than if the medical benefits had been pre-funded. This is because a "very low" discount rate is used to value those liabilities.

Mr. Reynolds next addressed pages 5 through 7, which indicate investment returns and funded status for the PERS and TRS plans. This information "deals with question: 'How did we get here?'" in listing data for the previous years and analyzing changes in the funded status of the systems categorized by source. He outlined the information on the graphs of pages 5 and 6. He noted that the funding status increased in some years and decreased in other years.

Mr. Reynolds explained the sources as follows: Non-Health Assumption Changes, includes mortality improvements or changes in retirement rates based on the consultant's analysis of the experience of the system; Health Assumption Changes, the primary instance being the expectation in which medical costs would increase in the future; Demographic Experience, determined by analyzing how the population has changed relative to the assumptions used; Plan Changes, as improvements in plan benefits; Medical Experience, how the medical costs changed relative to the expectations regarding increases; and Investment Experience, how investments performed relative to the 8.25 percent assumptions. The charts demonstrate the magnitude of the different sources on increases and decreases for various years.

Senator Bunde referenced the inset listing "Declines in funding status were caused by (in descending order of magnitude)" noting that demographic experience is the sixth-most contributing factor for PERS and the second most contributing factor for TRS. He asked the reason for the discrepancy.

Mr. Reynolds explained the demographic experience represents changes in the population that differ from the assumptions. This includes the rate and ages in which members retire, termination rates from active membership prior to retirement age, mortality experience and salary increases. Ordinarily demographic experience is a relatively minor factor because the system experience is

specifically analyzed in setting assumptions. The assumptions tend to be good predictors of actual occurrences. Demographic experience is a larger contributor for changes to the TRS plan as a result of a computer system change in the method of reporting teacher membership. The evaluation date for the systems is June 30 or July 1. The prior systems reported members as terminated at the end of the school year in the spring then re-hired in the fall for the following school year. These members were therefore not included in the data submitted to the consultant. Those members were then included in the data after the computer system change. This resulted in a loss to the TRS' funding status.

Co-Chair Green asked the year of this computer system change.

Mr. Reynolds replied the year was 2001.

Senator Stedman also noted that health assumptions was the second-most contributing factor to the PERS system and the fifth-most contributing factor to the TRS system and asked if different assumptions were used to calculate funding status for PERS and TRS.

Mr. Reynolds responded that health experience is not necessarily different between the two systems. The health assumptions are based on the rate that health care costs are expected to increase and are affected by "more national-type concerns". Therefore the same assumptions are used for both plans. The health assumptions are a larger factor in the PERS funding status than the TRS because the non-medical benefits are lower for PERS members than TRS members on average. As a result the medical liabilities are a larger contributor to the unfunded liability portion of the PERS plan and changes to the health assumptions make a greater difference to its funding status.

Senator Stedman asked for an explanation of the unbalance and whether it relates to the previous funding ratio and the weight given to the health assumptions.

Mr. Reynolds replied that the unbalance had nothing to do with funding, rather the legislated benefit levels of the two systems. The TRS system has somewhat higher non-medical benefit levels than the PERS system. As a result, a larger portion of the benefits is medical for PERS members.

Senator Stedman then pointed out that currently investment performance is calculated utilizing fair market value. In some years, many plans held assets at cost or "book value". He asked when, if ever, the Alaskan plan held assets at cost, or if the assets have always been held at fair market value.

Mr. Reynolds responded that the assets of the system are always accounted at fair market value when reported to the consultant on June 30 of each year. He qualified that assets may have been held at cost, but if so, it was many years prior. A smoothing method is used; however, cost is not a factor in that method.

Senator Stedman clarified that the analysis of all the assets, including bond packages, during the last decade have been market value and not cost.

Mr. Reynolds understood this to be so. The data submitted to Mercer Consulting lists the market value of the portfolio as of June 30 of each year and reflects the amount the portfolio could be sold for at that date.

Senator Stedman requested the June 30 information provided to Mercer for the past ten years.

10:27:30

Senator Stedman informed that he served on a municipal assembly and that ten years ago he recalled learning of an unfunded pension liability at that time. He wanted to assure that was an anomaly and not embedded in the analysis.

Senator Bunde expressed confusion about the previous computer system that did not include all teachers in the TRS system. He questioned the practice of reporting members as terminated then rehired for each school year. He asked how the plan could be managed without proper accounting of the members. He asked how this could have been allowed to occur, as it involved 90 to 95 percent of the membership.

Mr. Reynolds clarified that only approximately five percent of the members were reported in this manner. The consultants do not audit the accuracy of the data provided to it from the Division of Retirement and Benefits, although the information is reviewed to "reasonableness". Because of the minimal number of members affected, the discrepancies were not apparent. The conversion to the new computer system identified the discrepancy, which resulted in additional liability.

Senator Bunde was assured the amount was five-percent rather than 95 percent.

Mr. Reynolds overviewed the information contained on pages 7 and 8, which is a letter dated January 3, 2005, from himself to Ms.

Millhorn, that details changes in the funded percentages for PERS and TRS from July 1, 1992 through June 30, 2003. This information is based solely at fair market value of assets and involves no smoothing methods. The data could be different if smoothing methods were employed. The most significant factors affecting funding status for the past three to four years are investment experience and health care costs. However, over a longer time period, investment losses are a small contributor to funding status because the increases in market performance from the 1990s is factored in.

Mr. Reynolds pointed out that losses due to liabilities of 18.5 percent for PERS and 26.6 percent for TRS are significantly higher than losses due to assets of 3.8 percent for PERS and 2.7 percent for TRS. During the analyzed time period, investments performed below the 8.25 percent anticipated rate, although "not dramatically less". The majority of the changes are caused by the liability "side".

Mr. Reynolds reiterated the breakdown of the liabilities for both plans as: health experience, health assumption changes, plan changes, demographic experience, and non-health assumption changes. The aforementioned letter contains a chart listing the percentage impact on funded status of each factor in addition to the dollar impact on the unfunded liability of each factor over the 11-year time period.

Ms. Millhorn continued the presentation with page 9, a spreadsheet titled, "Public Employees'/Teachers' Retirement System Information Briefing". This delineates PERS and TRS members in the categories of active, deferred vested, deferred and retired, and into tiers. The total PERS population is 71,554 members, and the TRS total population is 22,098 members. The spreadsheet also describes the medical plans of the different tiers. As of December 2004, approximately 27,000 members received medical benefits. This combined with members' dependent coverage amounts to 52,000 people with medical benefits. This number is expected to increase in the future.

Ms. Millhorn referenced page 10, "Retiree Medical Insurance", a table listing the monthly premium per retiree for health coverage for each year between 1977 and 2003, the annual percentage change, and the average compounded annual increases. The health trend calculation was reassessed to 12 percent for approximately three years beginning in 2002, then decreases by one-half percent thereafter. She demonstrated the volatility of the actual rates by pointing out that in 1993, the rate decreased by seven percent, then increased by 37 percent in 1994 and in 1995, increased nine percent. Because of this volatility, it is difficult to trend

increases in health care costs. Data for the year 2005 is not included in the spreadsheet, although the actuarial benefit consultant has indicated the premium increase would be \$850, a 5.5 percent increase. The primary factor for this increase is "that it represents less than the projected claims costs" and fewer claims were submitted. This is beneficial for the year 2005; however, the impacts for 2006 are unknown.

Senator Stedman requested additional information on the structure of the medical insurance benefit. He asked if the State of Alaska is "stand alone" with the premiums set by the experiences of just the State, similar to a self-insured plan, or whether experience models from outside the State system are utilized.

Ms. Millhorn replied that the actuarial benefit consultant makes recommendations for premium increases to the Division based on experiences of the State as well as national trends. She would provide additional detailed information on this matter.

Ms. Millhorn informed of actions of the Division to address the increasing medical costs given the restraints of the benefits plans. These include positive enrollment requirements for retiree and active populations. This is an industry standard and involves members providing proof that claimed dependants are qualified as such through marriage licenses, birth certificates, etc. This practice would begin in the current year.

Ms. Millhorn told of another other efforts to utilize generic prescription drugs in place of brand name drugs where possible. Membership use of generic drugs has increased from 37 percent to 42 percent in the few years this has been facilitated. For each one-percent change from brand name to generic drugs, the plan saves \$1 million. There is misunderstanding regarding differences between generic and brand name drugs and the Division is providing education to the membership to clarify the matter.

Ms. Millhorn expressed that to the Division's "dismay" it was discovered the plan was not in compliance in verifying coverage for dependants between the ages of 18 and 23. The plan did not include a requirement that these dependants provide verification of college attendance. This omission had occurred for approximately 20 years. The Division has taken immediate action to remedy the situation in mailing letters to all members claiming such dependents notifying them of the new requirement to submit school transcripts proving full-time attendance. Of the 2,600 letters sent, the Division has received 1,300 replies. As a result the 1,300 dependents who did not respond have been un-enrolled in the system.

Ms. Millhorn also spoke of the annual renegotiations of third party administrative contract with Aetna. At the latest session, after Aetna had submitted a contract for increased fees, the Division was successful in negotiating a reduced fee schedule. This has resulted in an immediate savings of \$350,000. The Division also negotiated a "network guarantee" savings of approximately \$26 million in which the fee schedule for active and retiree members would be "flat" with no increase in fees "until and unless they can guarantee to the State of Alaska through a reconciliation process, that we will have a realized savings of \$30 million." If this occurs, Aetna would be able to recover some of the fees, up to \$470,000.

Ms. Millhorn continued to page 11 a spreadsheet titled "Public Employees' Retirement System, System Membership by Status" and a bar graph titled "Public Employees' Retirement System, 10-Year Comparison of Active and Retired Members." This information is garnered directly from the comprehensive annual financial report. She noted that in 1993, the system had approximately 9,100 members compared to 18,400 members in 2003, representing almost double the number of members in a ten-year time period. The year 2004 had a record retirement of 20,25 members. This has not occurred since the previous Retirement Incentive Plan (RIP) of 1995.

Ms. Millhorn noted page 12 provides information on a spreadsheet titled, "Public Employees' Retirement System, Expenses by Type (000's omitted)" and a bar graph titled "Public Employees' Retirement System, 10-Year Comparison of Expenses by Type". In 1995, health care benefits cost \$40 million compared to \$167,360,000 in the year 2004.

Ms. Millhorn noted identical spreadsheets and bar graphs on pages 13 and 14 utilizing data for the TRS plan. Again the amount of retirees has almost doubled in ten years.

Senator Stedman surmised from the trend that in a few years, the number of retirees would be greater than the number of workers. He asked if this is the forecast.

Ms. Millhorn responded that after reviewing workforce demographic information she concluded that a larger population would be eligible for retirement. She has not undertaken any analysis of this, but offered to calculate the percentages of members who would become eligible for retirement in different years.

Senator Bunde informed that the Department of Labor and Workforce Development has demographic information indicating that the largest segment of the population in Alaska is currently between the ages of 30 and 50. In ten years, this age group would represent the

smallest percentage of the population with the largest segments being senior citizens and children under the age of five.

Ms. Millhorn commented on the increase of health care benefit expenses for TRS from \$18,264,000 in 1995 to \$75,601,000 in 2004.

Ms. Millhorn continued that page 15 is a spreadsheet titled "Alaska Public Employees' and Teacher's Retirement System, Investment Return/Medical Costs - Assumption v. Actual & Mortality, Employer Actuarial Computed Rates and Board Adopted Rates, Rate Year FY 90 - FY 06". This summarizes the investment return assumptions, the recommendations of Mercer Human Resources Consulting and the actual adopted rates of the PERS and TRS boards.

Senator Bunde requested future explanation of why the PERS plan is governed by a regulation limiting annual increases in employer contributions to five percent and the TRS plan has no such regulation. He asked the Division to provide a recommendation of whether the regulation should be changed.

Ms. Millhorn would provide this information.

Ms. Millhorn pointed out that the information on page 16, a spreadsheet titled "Alaska Public Employees' Retirement System - Teachers' Retirement System, Composite Employer Contribution - Increase Amount and Total Contributions, FY 06 - 07 - 08 - 09" was also provided to the Committee the previous legislation.

Ms. Millhorn stated that the spreadsheet on pages 17 through 20, titled "Public Employees' Retirement System (PERS) & Teachers' Retirement System (TRS), Composite Employer Contribution Rate - Active Employers, Estimated FY 06 - 07 - 08 - 09 - Change in Employer Contribution" provides a detailed outline of individual employers. These calculations are based on five-percent increases.

Mr. Reynolds proceeded with pages 21 through 24, noting that the information demonstrates for each of the systems, Mercer's expectations of future actuarial calculated rates would be for the next 25 years under various assumptions. Most of the assumptions are cataloged in the valuation reports, although a few are shown in more detail on page 21 for PERS and page 23 for TRS. The assumptions for the two systems are similar.

10:49:55

Mr. Reynolds directed attention to page 21, a spreadsheet titled, "1.5(c) Actuarial Projections - Effect of Economic Scenarios". This lists future calculated contribution rates assuming that the

population of the active membership grows at a rate of one percent. This rate is reflective of the analysis of population growth of the past five years. He qualified this "appears reasonable" to the consultant, but is "not our opinion based on your demographics as to how your population will actually change in the future." The data on the spreadsheet assumes that the PERS and TRS boards would adopt the actuarial rate in each year. However, the five-percent annual increase limitation of the PERS board and the likelihood that the TRS board would practice similar restraint has been factored. Future investment returns have also been factored showing the 8.25 percent assumptions as well as a growth or optimistic scenario of higher investment returns over the next few years, and a pessimistic scenario of a prolonged recession in which investment returns are "poor" for the next three years then revert to a somewhat higher level but still less than 8.25 percent.

Mr. Reynolds noted that the chart on page 22 demonstrates the information listed on the spreadsheet on the previous page with the three investment return scenarios. Page 23 and 24 contain a similar spreadsheet and graph for the TRS system. The expectation is that the PERS rates would increase five percent per year for the next several years until the contribution rate reaches 27 to 28 percent. The rates are then expected to continue to gradually increase over the next 20 years until they reach slightly more than 30 percent. At that point, the intention of the funding method is that the unfunded liability would be eliminated and rates would begin to decline. The rates would vary in the event of higher investment performance or lower investment performance.

Mr. Reynolds listed the contribution rates for the TRS plan. Rates are expected to continue to increase by five percent per year for the next several years until rates reach 45 percent or higher. Rates would continue to more gradually increase to a level between 50 and 55 percent for the longer term. The rates would not be expected to decline until after a 25-year period of paying off the unfunded liability.

Mr. Reynolds pointed out that for each scenario the known investment returns of 15.08 percent for FY 04 have been factored.

Senator Stedman asked about asset allocation.

Ms. Millhorn indicated this subject would be addressed at the next meeting.

Senator Stedman noted the targeted rate of 8.25 percent, which "varies your allocation, in other words you set your target rate and you've got to set your allocation to attain it or visa versa."

He expressed curiosity on the probability of attaining that target rate. He also asked the impact of a lower rate or loss. These issues would be discussed at the next hearing.

Ms. Millhorn stated that the timelines for the PERS plan on page 25 and the TRS plan on page 26 show the impact of significant legislation to systems.

Senator Bunde requested future discussion on the impact of Retirement Incentive Programs (RIP) on the systems.

Co-Chair Green announced that the discussion would continue at the following meeting.

ADJOURNMENT

Co-Chair Green adjourned the meeting at 10:57 AM