

**MINUTES**  
**SENATE FINANCE COMMITTEE**  
**March 30, 2005**  
**9:05 a.m.**

**CALL TO ORDER**

Co-Chair Green convened the meeting at approximately [9:05:41 AM](#).

**PRESENT**

Senator Lyda Green, Co-Chair  
Senator Gary Wilken, Co-Chair  
Senator Con Bunde, Vice-Chair  
Senator Bert Stedman  
Senator Lyman Hoffman

**Also Attending:** SENATOR GARY STEVENS; TERRY THURBON, Acting Chief Administrative Law Judge, Office of Administrative Hearings, Department of Administration; RICARD J. SOLIE, SR. Vice-Chair, Teachers Retirement System Board; BRONK JORGENSEN, Member, Public Employee Retirement System Board; JAMES "PAT" WELLINGTON, Member, Public Employees Retirement System Board

**Attending via Teleconference:** There were no teleconference participants.

**SUMMARY INFORMATION**

SB 141-PUBLIC EMPLOYEE/TEACHER RETIREMENT

The Committee heard from the bill's sponsor regarding the proposed restructuring of the Retirement Systems' Board of Trustees. Testimony from current Public Employees' Retirement System and the Teachers' Retirement Systems Board members was heard. In addition, the Department of Administration testified in regards to the Office of Administrative Hearings. The bill was held in Committee.

#sb141

SENATE BILL NO. 141

"An Act relating to the teachers' and public employees' retirement systems and creating defined contribution and health reimbursement plans for members of the teachers' retirement system and the public employees' retirement system who are first hired after July 1, 2005; establishing the

Alaska Retirement Management Board to replace the Alaska State Pension Investment Board, the Alaska Teachers' Retirement Board, and the Public Employees' Retirement Board; adding appeals of the decisions of the administrator of the teachers' and public employees' retirement systems to the jurisdiction of the office of administrative hearings; and providing for an effective date."

This was the sixth hearing for this bill in the Senate Finance Committee.

[9:08:21 AM](#)

Co-Chair Green commented that today's discussion would concentrate on the proposed restructuring of the Public Employees Retirement System (PERS) Board and the Teachers Retirement System (TRS) Board.

Senator Stedman, the bill's sponsor, noted that today's discussion would be aided by a slide presentation and a corresponding handout titled "Retirement Security Act SB 141 Discussion Topic Board Restructuring March 30th, 2005" [copy on file].

Senator Stedman stated that, as depicted on the flowchart on page three of the handout, the current State retirement system consists of two components: one being the Structural Component, which is administered by the Department of Administration (DOA), and the second being the Financial Component, which is administered by the Department of Revenue (DOR). The DOA oversees the PERS and TRS Boards; the State's actuarial consultant; and the Division of Retirement and Benefits. As reflected on the chart, the primary responsibilities of the PERS and TRS Boards include adopting policies and regulations, acting as an Appeals Board, setting the annual PERS and TRS Employer Contribution Rates, and adopting the actuarial assumptions. A significant amount of the PERS Board's time is consumed by its Appeals responsibilities.

Senator Stedman stated that the DOR is also oversees the Alaska State Pension Investment Board (ASPIB), which is responsible for establishing investment policies and managing and investing retirement trust funds. Callan Associates, a private consultant, provides performance comparison reports to both ASPIB and the Department.

Senator Stedman stressed that the activities of ASPIB are "highly related" to the PERS/TRS Boards' decisions regarding the establishment of the Employer Contribution Rate and the adoption of the actuarial assumptions.

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- Retirement System Oversight Should Be Designed To:
- Guide and evaluate system performance
- Provide long-term strategic and financial planning
- Ensure the assets and liabilities of the systems are balanced
- Implement formal system of checks and balances
- Work in the best interests of the state and it's public employees

Senator Stedman read the Retirement System Oversight objectives and impressed upon the Committee that there is currently a \$5,700,000,000 imbalance in the asset and liabilities components of the retirement systems. Designing a system that would maintain a balance between the assets and liabilities is critical.

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Retirement Board Must Be

- Representative of all system stakeholders
- Experienced and knowledgeable in relevant financial, accounting and investing issues
- Empowered to address systemic problems
- Impartial - include non-beneficiaries
- Independent

Senator Stedman stressed the importance of seating Board members who "understand and comprehend" these components; they must be "fully engaged in those areas of discussion". Impartiality and independence "is important on virtually all boards in the private and public sector".

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SB 141 Board Restructuring is Designed to:

- Strengthen the fiduciary oversight of the entire retirement system
- Place system assets and liabilities within the purview of one authority
- Increase the frequency of reviewing, adopting and reporting actuarial assumptions

- Increase employer and non-beneficiary representation on the board
- Establish minimum professional qualifications for board membership
- Move the quasi-judicial appeals process to the Office of Administrative Hearings
- Empower the Commissioner of Administration to set policies and regulations for day to day system operations

Senator Stedman declared that a lack of communication between the PERS and TRS Boards and the willingness to place blame elsewhere are key reasons a single Board component is being proposed in this legislation. A lack of communication and responsibility does not "facilitate good public process". Increasing the frequency of reviewing actuarial assumptions would assist in allowing the system "to recognize that it is off course ... and get back on course easier". Increasing the employer and non-beneficiary representation on the Board would address the concern that employers "who bear the brunt of the liability exposure", are currently under-represented on the Board. The establishment of minimum professional qualifications would insure that informed independent decisions are made and would assist in moving appointments away from "the political arena".

Senator Stedman stated that, currently, three-quarters of the PERS/TRS Boards' time is dedicated to hearing Appeals. The restructuring proposed in this legislation would move the Appeals process to the Office of Administration Hearings (OAH) within the DOA. This would allow the single Board being proposed to devote more attention to the Employers Contribution Rate and other policies and regulations.

Senator Stedman noted that the information presented on page seven depicts the flow of duties and responsibilities as proposed in this legislation. The Division of Retirement & Benefits would assume oversight of the day-to-day operations of the retirement system and the OAH would hear appeals. He noted that the OAH would be testifying regarding the impact the proposed changes might incur on them, and to that point, he surmised that the testimony would indicate that OAH would be able to handle the workload.

Senator Stedman shared that the Alaska Retirement Management Board (ARMB), which is the single Board being proposed, would function within the DOR Division of Treasury. An investment advisory council, an investment consultant, and an actuary would assist the ARMB. A single Board would "better answer" Legislative questions regarding such things as the Retirement Fund's liabilities, assets,

its liability/asset balance, and policy implications. Furthermore, a "consolidated" Board could more comprehensively comment in regards to how any future legislation might affect the retirement system. The Board's responsibilities would include managing and balancing the Trust's assets and liabilities; establishing investment policies and options; setting the annual PERS/TRS Employer Contribution Rates; and reviewing and adopting actuarial assumptions.

Senator Stedman, in discussing the responsibilities of the ARMB, warned that it would be "extremely dangerous" to implement a portfolio policy that "would increase the risk exposure in the attempt to close the \$5.7 billion gap". That "is not the intent" of this legislation. The goal would be to obtain "an asset/liability match not an asset/liability mismatch". When determining the annual PERS and TRS Employer Contribution Rate, "it is critically important when you have the assets matching the liabilities, that you don't have an entity setting contribution rates that may be detrimental to that". Because a balanced system is the goal, language has been "intentionally" incorporated into this legislation to prevent the Contribution Rate from being set below the Normal Cost Rate. Multiple boards going multiple directions must not be tolerated. The desire is that the new Board would review and adopt actuarial assumptions that would work with the portfolio policy to increase the growth of assets faster than the growth of liabilities. The reverse of this is currently being experienced due to the escalating cost of health care.

[9:24:23 AM](#)

Senator Stedman underscored the fact that on occasion, imbalances in the growth rates of assets and liabilities would be experienced. The concept behind this legislation "is not to turn the system upside down and escalate the Contribution Rates to the sky and move the portfolio allocation to the riskier asset classes hoping that we are going to close that \$5.7 billion gap", as that would not be "a prudent way of doing it. Nobody sitting at this table, I think, would stand for that".

[9:25:16 AM](#)

Senator Bunde queried about what might occur were no qualified PERS/TRS Board candidates available.

Senator Stedman voiced the understanding that the proposed qualifying criteria for the PERS/TRS Board member positions on the Board is "looser" than the requirements specified for the other Board members in that they would simply be required to be a PERS or

TRS member. He reminded the Committee that under this legislation, the OAH rather than the Board, would assume the responsibility for the appeals process. The responsibility of meeting the liabilities is a responsibility of the employer in that, when the system becomes unbalanced, it is the employer rather than the employee who must contribute a higher Contribution Rate to pay for an unfunded liability. "If the employer has the responsibility, regardless of asset performance, regardless of inaccurate growth assumptions or growth rates for the future of health care, ... the employers need to be sitting at the table overseeing and calling the policy shots".

Senator Stedman informed the Committee that the ARMB would be comprised of nine trustees: the Commissioner of the DOR; the Commissioner of the DOA; three public members who must be Alaska residents who are not beneficiaries of the plan; one finance officer of a political subdivision; one finance officer of a school district; one active or retired PERS member; and one active or retired TRS member.

Senator Stedman announced that any amendments and ideas to further this discussion would be welcome. "Nothing is set in concrete". The people who shoulder the liabilities must participate in policy decisions.

[9:28:44 AM](#)

Senator Bunde agreed, and voiced being pleased that PERS/TRS members would have less rigorous qualifiers than other Board members.

[9:29:08 AM](#)

Senator Hoffman asked the sponsor's view about electing, rather than appointing, Board members; the exceptions being the commissioners of the DOA and the DOR.

[9:29:24 AM](#)

Senator Stedman preferred seating members via the appointment process. While acknowledging that there has been testimony in support of electing the PERS/TRS members by their fellowships, he suggested that a better approach would be for the organizations to develop a list from which the Governor could appoint.

Senator Hoffman asked whether the appointees must be confirmed by the Legislature.

Senator Stedman understood that no Legislative confirmation is

required.

Co-Chair Green likened the proposed appointment process to that currently in place for the Permanent Fund Investment Board of Directors.

Senator Stedman specified that Board members could serve for three-three year terms and, after a one-year hiatus, could be re-appointed. It has also been suggested that the Commissioner of the Department of Health and Social Services be included as a Board member due to the fact that health care cost issues have such impacts. While modifications to the proposed Board membership should be discussed, he cautioned that significantly increasing the size of the Board would make the process "unmanageable". "A nine-member Board is more effective than an 18-member Board".

[9:31:25 AM](#)

Senator Bunde pointed out that the language pertaining to Board membership, as specified in Section 40(b) on page 36, does not differentiate the qualifications of the PERS/TRS members from those of the other members.

Senator Stedman responded that the language would be reviewed.

[9:32:01 AM](#)

Co-Chair Wilken affirmed that the ARMB appointment process would resemble that of the Alaska Permanent Fund Board. Continuing, he inquired to the compensation for ARMB members.

Co-Chair Green remarked that Board member compensation is specified in the bill at the current per diem rate of \$150 per day.

Co-Chair Wilken understood that Board members would be entitled to the per diem rate in addition to regular travel compensation.

Senator Stedman stressed that the responsibilities of the ARMB are substantial, and a stipend would assist in attracting quality individuals. While there would be "some prestige" associated with being a member of such a Board, the responsibilities would be challenging, as the Board would be responsible for the retirement funds for the people of the State of Alaska; children to senior citizens.

Co-Chair Green informed that Board member compensation is addressed in Section 43 beginning on line 20, page 40 of the bill.

Senator Stedman stated that, at this time, Ms. Thurbon with the Office of Administrative Hearings would be presenting her testimony.

TERRY THURBON, Acting Chief Administrative Law Judge, Office of Administrative Hearings, Department of Administration, affirmed that the OAH would be able to assume the responsibilities associated with PERS/TRS appeals, as such types of hearings are not dissimilar to the types of hearings the OAH currently conducts. Furthermore, as a result of recently enacted legislation, as of July 1, 2005, the OAH would be assuming responsibility for a broad range of appeals including complex Department of Commerce, Community and Economic Development Division of Occupational Licensing cases; Permanent Fund cases; Child Support Cases; and a variety other cases. She assured that the OAH would be capable of conducting PERS/TRS hearings.

Ms. Thurbon specified that the OAH essentially addresses three categories of cases: direct appeals, mandatory referrals, and discretionary referrals. The latter are cases that agencies are not required to submit to the OAH but do so in order to take advantage of the services OAH provides. OAH conducts discretionary appeals according to the agency's procedural manner. Direct appeals include such things as tax appeals. Currently, the bulk of OAH's current jurisdiction, or case docket, is in the mandatory referral category. "Those appeals are subject to some very specific procedures" that were adopted in SB 203 in 2004. Its provisions, which become effective July 1, 2005, include a time efficiency process specifying a case timeframe of approximately 165 days.

Ms. Thurbon characterized the PERS/TRS appeals cases as being a hybrid of the current three case categories. They would be a direct appeal in the sense they would come directly to OAH. OAH would be the final decision maker, and any appeal of its rulings would be to the State Superior Court. The PERS/TRS appeals cases would be subject to the efficiency procedures cited in SB 203. There is no reason current OAH procedures could not be applied to the PERS/TRS cases.

[9:37:49 AM](#)

Senator Bunde, inquiring about the expected PERS/TRS appeals caseload, asked whether additional OAH staff might be required.

Ms. Thurbon affirmed that there would be an impact on Administrative Law Judge (ALJ) staff time. Whether it would require new hires or a shifting of staff caseloads is unclear at this time. Were the caseload to reach "critical mass", staff might be added.

Oftentimes, non-permanent positions or an ALJ contract is established in order to address the situation. Moving the PERS/TRS appeals to the OAH would increase ALJ caseloads, particularly in the initial transition phase, as she understood that there is currently a backlog of PERS/TRS matters that have not been presented to the current PERS/TRS Boards. An increase of one ALJ position might be required the first year and a three-quarter time position might be required thereafter. An increase in administrative support staff should not be required.

Co-Chair Green asked whether the OAH has any concerns or suggestions regarding language in the bill.

Ms. Thurbon responded that, while further study of the bill would be conducted, the bill's language is not "troubling". Procedures could be fine-tuned to align provisions with current Office procedures or authority such as requiring an ALJ to have a certain level of expertise in a specific area.

Co-Chair Green requested that OAH suggestions be provided to her and Senator Stedman's offices.

There being no further Committee questions, Co-Chair Green thanked Ms. Thurbon for her testimony.

Senator Stedman concluded his remarks about the proposed ARMB and voiced appreciation to the OAH for the testimony and for working with his office on this legislation.

AT EASE [9:42:15 AM](#) / [9:43:11 AM](#)

Senator Stedman qualified that the bill would continue to be a work in progress, as Committee Members' and others' questions and concerns are addressed. A new committee substitute would be developed and distributed. The entirety of information that has been collected in the development of this bill is available to interested parties.

Co-Chair Green announced that public testimony would commence.

[9:44:49 AM](#)

RICARD J. SOLIE, SR. Vice-Chair, Teachers Retirement System Board, shared that his background includes being a retired Economics Professor, Economics Department Head, and Acting Dean of School of Management at the University of Alaska. He was initially appointed to the TRS Board in 2003 and reappointed to a full term in 2004. He served on the PERS/TRS Boards' four-member Tier Review

subcommittee.

Co-Chair Green asked Mr. Solie to share his perspective on the subject at hand.

Mr. Solie stated that while he had developed written comments titled "Draft Outline of Major Points For Testimony Before Alaska Legislature, March 29-31, 2005" [copy on file], he would limit his remarks to the issue of Board Re-Structuring, as that is the topic of today's hearing. He also understood that other PERS/TRS Board Members had recently shared their thoughts on the reorganization of the retirement system. In developing his remarks, he had placed the reorganization of the Boards in third place behind other subjects that he held stronger opinions about. In general, he viewed the effort to increase the professionalism of Board Members and the emphasis placed on allowing more input from the public sector as "positive factors". Nonetheless, he questioned the balance of the proposed Board make-up because the PERS and TRS Boards, as currently structured, are trustees of the funds into which the members have contributed. Those funds, which represent the retirement for these individuals, are "an extremely important thing for them and, as a consequence, I feel that majority representation on the part of persons in those systems is not inappropriate". Continuing, however, he opined that it is also "not inappropriate to have public representation of individuals who are not part of the system" nor is it inappropriate to have employer representation on the Board. There should be, however, "significant" PERS/TRS member representation on the Board.

[9:49:43 AM](#)

Mr. Solie voiced "some concern" regarding the proposed appeals process in that, in his experience as a member of a National Panel of Arbitrators, American Arbitration Association; in most instances an arbitrator hears cases as a single arbitrator, similar to the OAH process. An arbitrator often presides over cases in which they have general rather than "specific expertise". Typically, they would not preside over a case involving their peer group. The "one significant difference" between arbitration and the proposed appeals hearing is that the arbitrator is selected by and agreed upon by both sides of the issue. In such a process, "the arbitrator has a basis for trust". This would not be the case as proposed in this legislation, as the OAH is housed within the DOA and "would be hearing appeals of issues that had been decided by the Department of Administration". This is "a real concern ... that process would lack confidence" by the individual appellants. This could result in there being "a damaging affect on morale".

Mr. Solie communicated that the TRS Board does not address as many appeals as the PERS Board, whose appeals primarily consist of disability issues. "Disability issues are not nearly as significant on the teachers' side due to the nature of their work". Initially, he had expected the TRS Board to be sympathetic to members' appeals; however, he found that the Board was "very rigorous in their judgments" and in most cases he was involved with, the TRS Board sided on the part of the Administration. He understood that this was similarly the case on the PERS side.

[9:53:04 AM](#)

Mr. Solie stressed that the PERS/TRS appeals process, as currently structured, "is a jury of peers". That concept "has a hollowed place in our society". Changing this process should not be done "lightly".

Mr. Solie spoke to the proposed changes in the financial structure of the system by stating that he is "especially concerned about the idea of the matching of assets and liabilities". "On the surface", it might be appealing; however, he questioned whether it would prove to be so upon more in-depth analysis. The determination of benefit levels is a significant factor in determining Fund liabilities. The current PERS/TRS Boards "essentially have no authority" in this regard, and he understood that this responsibility would also not be assigned to the new "Super Board".

Mr. Solie declared that the Legislature has the primary responsibility for determining retirement benefit plan provisions. Health care determinations are a combination of administrative or Legislative decisions rather than being Board directed. The Board could develop recommendations and has, over time, compiled significant cost-saving recommendations. "The role of the Boards in determining benefit levels is minimal". In contrast, the Boards have been very involved in reviewing actuarial assumptions and monitoring actuarial performances. "There have been some problems with this in the past". The hope is that that aspect would improve; however, he was unsure whether the creation of a Super Board would improve that, as this would be an additional burden "on top of an already heavy responsibility in terms of the investment of the funds". While he declared that he is "very impressed with the boards as they are now constituted", requiring stronger Board member experience might be a positive factor in regards to their monitoring responsibility.

[9:57:32 AM](#)

Mr. Solie voiced being uncertain as to how the new Super Board

could improve the matching of the liabilities to the assets; but the new Board member experience criteria might provide some benefits in this regard. The other "critical component" in matching assets and liabilities is the rate of return. An increase or decrease in the assumed rate of return has "a tremendous impact on the estimated actuarial liabilities". There would be no impact on the value of future liabilities. He voiced concern that the Super Board might, in an effort to match future assets to high liabilities, raise the discount rate on the asset side. This action would serve to reduce liabilities and increase asset projections. This would solve a lot of problems; however, increasing the discount rate in order to meet the liabilities, would serve to increase the risk involved in the portfolio. Placing this responsibility on the Super Board "would be very, very dangerous".

[10:00:04 AM](#)

Co-Chair Green, noting that the Committee had previously addressed this issue, asked Senator Stedman to further expand on possible solutions regarding the issue of matching liabilities to assets. She understood that assuming higher risks was not part of that process.

Senator Stedman stated that numerous portfolio strategy options could be applied in regards to the discount rate issue and the issue of matching liabilities to assets. One option would be to identify a total rate of return with a targeted rate. The targeted rate currently is 8.25 percent.

Senator Stedman remarked that implementation of "front-end accounting" by increasing the targeted rate of return, for example, from 8.25 percent to 9.25 percent, to address the \$5.7 billion under-funding should not be considered as doing so would shift the portfolio into riskier asset classes; would increase volatility; and would subject "the overall liability/asset mismatch to more variability". Were the Super Board or the SPIB Board to decide policy to that effect, there would be considerable objection from the people who would have that liability exposure. In this case, that would be the State.

[10:02:14 AM](#)

Senator Stedman objected to following a policy course that would increase the targeted rate as a means through which to balance assets and liabilities. Other mechanisms should be discussed in the future to address that issue. Absent the current situation and were the assets and liabilities to match, strategies and policies could be implemented to control the risk exposure of a liability/asset

mismatch. One challenge that must be recognized is the growth assumptions in health care. He recalled that several decades earlier, a "classic asset/liability mismatch" in the savings and loan industry demolished the industry, and the federal government became involved. The outcome of that situation was that the savings and loan industry was absorbed within the banking system.

Senator Stedman agreed "100-percent" that increasing the discount rate would be the incorrect approach to addressing the asset/liability imbalance. The Legislature, as stewards of the State, should require a Board to justify its targeted rate. His concern with the present situation is that ASPIB transmits a target rate to the actuary. Then the actuary via the PERS/TRS Boards provides the rate to Mercer Financial Consultants, who manages the discount rate. To his understanding, "the discount rate is not necessarily set by the actuary". But rather, the ASPIB Board, as a result of the asset allocation they impose, determines the rate. This allocation is currently approximately 30-percent bonds a substantial amount of equities, and real estate holdings. The perfect scenario would be to "tie in" the growth of the assets and the liabilities going forward. The unfunded liability should be addressed separately. "There's absolutely no intent to take the \$11 billion portfolio and start pouring high octane fuel in it, hoping we can close the gap ... that would be an unacceptable way of solving the problem".

[10:05:23 AM](#)

Senator Stedman declared that the efforts should concentrate on shorter financial projection timeframes. One or two year projections are "more probable" than twenty-year financial forecasts. "Our obligation here is to meet the" State's immediate cash flow demands. Incremental increases in the Employer Contribution Rate are affecting school districts and cities' cash flow. The \$11 billion "portfolio can run for years without any infusion of capital". The immediate cash flow issue is the short-term struggle. The long-term objective is to balance the assets and liabilities to further assist in solving the unfunded liability.

[10:06:31 AM](#)

Co-Chair Green recalled that, the previous year, the Legislature had requested the Boards to provide recommendations through which to address the unfunded liability in addition to the request that a Tier Redesign be undertaken. The recommendations could have included such things as a cash infusion to the Retirement Fund from the State, pension bonds, and other types of financing. In addition, the Administration was addressing the issue by

contemplating changes in the benefits or medical plan or plan deductibles with the caveat that the no benefits of the plan could be diminished. The Administration's efforts might or might not require legislation. To date, no recommendations have been forthcoming from the Boards.

Co-Chair Green declared that the same request would be asked of the proposed Board. The Legislature requires this advice, as they, rather than being members of the Board, are "the appropriators". The advice of "a very professional Board" that reviews the contribution rates and the investments could provide "possible solutions" to the issues. That, rather than re-configuring rates and percentages, allocations, investment strategies, was the point of the discussion pertaining to assets verses liabilities.

[10:08:47 AM](#)

Mr. Solie specified that no such Legislative request had been received by the Boards. Had the Board been aware of the request, they would have responded. He voiced disappointment, as a member of the Tier Review Subcommittee, that the Subcommittee's tier recommendation not been approved.

Co-Chair Green remarked that the Legislature was disappointed as well.

Mr. Solie voiced the understanding "that the only thing" that the Tier Review Subcommittee "had been requested to do was to pass our recommendations onto the Administration which would then funnel them to the Legislature". The Board was unaware that the desires of the Legislature more extensive.

[10:09:46 AM](#)

Co-Chair Green remarked that the Legislature's request for the Boards' recommendations had occurred in the same conversation as the request regarding a tier review.

[10:09:49 AM](#)

Senator Stedman recalled that during the Board meeting in which the Tier Subcommittee had presented its' recommendations about the proposed hybrid and defined contribution plans, one of the Board members had commented, "why bother, the Legislature is going to do it anyway". Therefore, he questioned the Boards' efforts.

Co-Chair Green expressed that while the purpose of today's hearing is not to put the testifier or anyone "on the spot", "there is a

great deal of frustration" on the part of the Legislature. The Legislature does not have the expertise to solve the situation and would welcome recommendations, suggestions, or concerns about the issue. The bill's sponsor would be willing to listen and attempt to incorporate ideas into the legislation. Rather than harboring "ill-will", the Legislature is just "frustrated" that no one has stepped forward to take responsibility for the situation. "Somebody somewhere messed up". Regardless of whether blame could be placed on the actuary, the consultant, the Boards, or the Legislature, there is a \$5.7 billion shortfall that must be addressed. It could be "guaranteed" that, "change is coming".

[10:11:32 AM](#)

Mr. Solie commented that while there might "have been some mess-ups, some of the key things that happened could not have been reasonably anticipated". The Boards had "very little control" over the compilation of events that has been referred to as the "perfect storm".

Mr. Solie agreed with Senator Stedman's remarks regarding the review of the actuarial assumptions. The Boards should have reviewed the assumptions "more closely"; specifically the health care trends, as, in retrospect, it appears that the actuary erred in that regard. He noted out that "the Boards refused to adopt the assumptions embodied" in a recent actuarial report, primarily out of concern that the situation might be continuing. As an aside, he voiced support for the recent health care trend methodology change that separates pharmaceutical and medical trend information. The Boards had "significant concerns about the rate of decline" in those trends as proposed by the actuary. However, the actuarial repeatedly justified the rates being lowered by their belief that the current level could not be sustained "indefinitely"; continuance of the rates at the current levels would negatively impact the Gross Domestic Product (GDP). While he agreed that the rate levels could not continue indefinitely, no one has "any idea of what level the economy is going to absorb" or how long they might decline. "The statement was made to the actuary" that the rates should not be dropped until the system undergoes structural changes that would provide confidence that the rates would eventually lower. "The Boards are taking a harder look" at assumptions, particularly those pertaining to health care. The actuaries were charged with re-evaluating this area, and in addition, a request was made that the Administration to have an independent review of the trends by such entities at Aetna Insurance Company. These trends are "critical" and absent reliable information, similar situations would reoccur. In summary, errors did occur, and while some events were unanticipated, a better

review must be priority.

Co-Chair Green voiced appreciation for Mr. Solie's work on the Tier Review Subcommittee.

[10:15:11 AM](#)

Senator Stedman voiced appreciation for the Board's questioning of the actuarial assumptions, particularly those supporting a downward trend in health care expenses. Additional years of underestimating the Fund's liabilities could not be tolerated.

Mr. Solie warned that incorporating insufficient trend lines into the current actuarial report would serve to increase the unfunded liabilities. "Reality" must be reflected.

Co-Chair Green agreed.

[10:16:22 AM](#)

Mr. Solie reiterated that his comments to this point were spontaneous, as his prepared testimony was intended to address other matters. He noted that his aforementioned written commentary was purposely written in generic form, as he was uncertain as to which Legislative body he would be testifying. He also noted that even though the Member Contributions section of his notes contained two subsections, he would not be presenting the subsection titled "B. Equal sharing of contributions for 'Past Unfunded Liabilities'" as that issue is not relevant to this legislation.

Mr. Solie voiced being "philosophically in agreement with the idea of equal sharing of Normal Costs". Were the recommendations of the Tier Review Subcommittee reviewed, it would be noted that the recommendations of the Subcommittee, "included employee costs that were as great or greater than those of the employer for the Normal Costs". While he agreed with the concept, there is concern that applying it to existing employees might present some "serious" problems, including judicial challenges.

Mr. Solie voiced concern that, as stated in his written comments under Member Contributions A.2., "the five percent per year increase is a very stiff increase for an individual employee. That probably wouldn't come into play; however, if the equal sharing was limited to 'Normal Cost'" as, per this legislation, the maximum increase an existing employee would be required to contribute is approximately three percent. While he would not delve into the Section on "Past Unfunded Liabilities, he has "serious concerns".

In response to a question from Co-Chair Green, he clarified that his concern in regards to "Past Unfunded Liabilities" focuses on employees being required to contribute an equal share to Past Unfunded Liabilities. He reiterated that, while this concern is not an issue at this hearing, as that obligation is not incorporated into this legislation, he would have serious concerns had it been addressed or considered at a later time.

[10:20:02 AM](#)

Mr. Solie voiced his "great concern" about implementing a 100-percent Defined Contribution (DC) plan and, to that point, he reviewed the "Introduction of a 100% DC Plan to Replace the Existing DB Plan" section of his written comments as follows.

Introduction of a 100% DC Plan to Replace the Existing DB Plan.

- A. First of all, let me say that I am not opposed to the general concept of DC plans or of privatized retirement plans. I strongly believe in individual responsibility and in the advantages of personal ownership of private equities.
- B. I am sure that all of you are aware that, although the Tier Committee did forward to the full boards an Alternative 2 which was 100% DC, the committee was unanimous in opposing its adoption.
- C. I personally pressed for a hybrid plan that included both a 1% DB and a DC component. Although some of the committee members undoubtedly had misgivings about it, there was a clear recognition of the serious problem facing the State of Alaska with respect to the retirement plans, and consequently the Tier Committee voted unanimously to support the hybrid plan.
- D. There are several reasons for the committee's and my personal opposition to a 100% DC plan.
  1. A key factor is that in Alaska most of the teachers in this state are not covered by Social Security. Thus, they lack the floor of retirement benefits that is available to private sector employees and to public sector employees in most other states. The 1% DB plan that the Tier Committee proposed would provide such a floor.

[10:22:30 AM](#)

Co-Chair Green asked whether any school district in the State would have the authority to develop its own employee retirement plan.

Mr. Solie affirmed that they would.

Co-Chair Green declared therefore that, "it is not the State's purview to say this is the only plan" that a school district would have available to them. Each district could develop a plan that would be appropriate for its employees.

Co-Chair Green, after determining that Mr. Solie would be available to speak to the Committee at a later date, asked that, at this time, other persons in the room be provided the opportunity to testify before the Committee.

Senator Stedman informed the Committee that "the floor issue", which is a legitimate concern in regards to the 100% DC plan, had been a topic of discussion during the drafting of the bill. It was concluded that this concern could be partially or in whole "mitigated by offering a fixed rate option" in the investment selections.

[10:24:28 AM](#)

Senator Bunde stated that there could be a remedy in regards to the issue of someone who qualifies for Social Security (SS), in addition to being a TRS member. He, and other teachers he is aware of, had worked in the private sector and as such would qualify for SS.

Co-Chair Green informed that the discussion with Mr. Solie would continue during the March 31, 2005 Committee hearing.

BRONK JORGENSEN, Member, Public Employees' Retirement System Board, agreed with the majority of the Mr. Solie's comments. He noted that in the year since his appointment to the PERS Board, he has "been impressed with the workings of the PERS, TRS, and ASPIB Boards" who spend considerable time reviewing the volumes of data that pertinent to their responsibilities. He disclosed that he is self-employed and has no vested interest in PERS. As a member of the Tier Design Review Subcommittee he voted in support of Alternative 1, which is the hybrid plan. It had been his understanding that the Legislature was going to forward that plan. He also agreed with Senator Stedman that the Board should have provided recommendations to the Legislature. Alternative 1 was a good plan for all concerned parties: "employees, employers, and all Alaskans since everyone is affected". However, one of the reasons for Board hesitancy was the

belief that other options might be available to address the under funding issue generated by "huge medical costs" and "abuses and loopholes

Mr. Jorgensen clarified that the majority of the Board's efforts during his tenure have concentrated on Appeals. Appeals are the result of disagreements between employees and employees and employers. He affirmed that Mr. Solie's assertion that the PERS Board addresses more Appeals than the TRS Board due to disability factors, and there being a larger number of PERS members. Were the Board's Appeals ruling to be unacceptable to either the administrator or the appellant, it could be appealed to the Alaska Court System. This would also be an option in this legislation. The parties involved in the current Appeals process view it as "fair and reasonable" and most appellants are satisfied with the decision of the Board, even were the ruling not in their favor. Few cases advance to the Court and of those few are overturned. He estimated that the Board rules in favor of the appellant fifty percent of the time and for the Administration fifty percent of the time.

[10:28:13 AM](#)

Mr. Jorgensen opined that were the Appeals process to shift to the OAH as proposed in this legislation, the State would incur additional legal and court expenses. While the majority of PERS and TRS members are satisfied with the Board's decisions in the current appeals process, it is doubtful that they would be happy with the OAH decisions. "It would be viewed as the same decision coming from the current Administrator" and as a result, more appeals would be taken to the Court System.

Mr. Jorgensen echoed the concerns regarding the March 2005 Mercer Financial Consultants actuarial assumptions report. Changes must be made, and while he was unsure of the answer, discussions could include the hiring of a new actuarial firm or re-evaluating the current arrangement with Mercer. He voiced appreciation for the discussions that have occurred, as the issues are complex.

JAMES "PAT" WELLINGTON, Member, Public Employees Retirement System Board, stated that he, a retired State Trooper, has been an elected member of the Board for 27 years and, in addition, has been an elected member of the ASPIB Board since its inception in 1992. His election record speaks favorably about his service. He allowed however that most PERS Members are "probably" unaware of the duties of the Board since non-Board member attendance at Board meetings is small since the meetings "are not really that exciting".

[10:30:35 AM](#)

Mr. Wellington proclaimed that the Boards essentially underwent "a complete restructuring" a few years earlier when the Administration changed. Governor Frank Murkowski replaced the three appointed members of the PERS Board, and while he "did a fine job in picking" the new appointees, the Board members they replaced were also "decent" people with good backgrounds. Governor Murkowski has appointed the majority of the five-member TRS Board. The eight-members of the ASPIB Board consist of two elected PERS members, two elected TRS members, the Commissioner of Revenue who is was a Governor appointee, and two new Governor appointees. One seated member was re-appointed by the Governor, and one member who was appointed by the previous Administration remains on the Board. "Basically", the Boards "have started over within the last year and a half". To that point, he questioned "the rationale ... of starting over a second time".

Mr. Wellington, mentioning that the three Boards had recently held a joint meeting as required by State Statute, declared that the Boards "step up to the plate" and address their assigned responsibilities. The Boards "work well" and have never done "any finger pointing" "or stepping aside and hiding to blame somebody else for what's going on". The figures provided by the actuarial consultant, "who is under contract to the Department of Administration Division of Retirement and Benefits", have been questioned for a number of years, "but unfortunately, the actuary has all the computers and machines and do the work; the Division of Retirement and Benefits" devotes a lot of time to reviewing "those documents and assumptions and how they got to where they did". The PERS/TRS Boards are provided approximately one day to review the assumptions. The Boards have repeated asked Department's administration whether they "are comfortable after your staff review that these assumptions are correct". "For the most part, the answer is 'yes'". While the Boards ask questions, they do not have the time or the technical expertise to conduct a more thorough review and rely heavily on the Division of Retirement & Benefits "technical expertise to evaluate these reports".

[10:34:47 AM](#)

Mr. Wellington stated that while the Boards have been available, they have "never been invited" to testify before any Legislative Committee. Members are here today because "we have on our own, sought out" and reviewed the information. Members are not informed about pending legislation and must conduct research themselves. He read from an email [copy not provided] he had sent to the Director of the Division of Retirement & Benefits in February 2005, as follows: "Just as a point of interest, it would seem to me that the

Legislative committees might be interested in knowing first hand why the Boards voted the way they did on Tier III for TRS and IV for PERS. Therefore it would be reasonable for you to offer testimony and comments from the respective Board chairs. Right now the Legislative committees are only hearing the viewpoint of the Division". No response to that e-mail was received. The Boards would welcome the opportunity to discuss issues.

Mr. Wellington stated that the tier work conducted by the Tier Review Subcommittee was excellent; however, they "strayed" from their "single task" of developing a defined contribution program as requested by the Administration, and developed a "hybrid" program. The Administration did not ask them to address the cost over-run that exists in the Retirement Plan. When the Subcommittee began discussing a hybrid system, the Administration "summarily told 'That's not your charge.' Your charge is to come up with one thing and one thing only'".

Mr. Wellington continued that he and other Board members felt that other issues, such as health care, were driving the overrun of the Fund. Therefore the Subcommittee deemed it prudent to conduct an overview of the entire system and determine what components might be addressed in the short term, mid-term, or long-term. The health care component could be addressed in the short term while the defined contribution program was long-term. The cities today are not going to see any relief in this area for a number of years. Nonetheless, no opportunity was provided in which the Boards could sit down and determine what could be done collectively to view the entire system. The Boards' Health Committee has looked at options to reduce health costs. One of the things discussed with the Administration was that of educating PERS/TRS members about the use of generic drugs. The increased use of generic drugs has been "very cost effective" and has saved the Retirement System millions of dollars.

Mr. Wellington disclosed that the Boards have asked the Division of Retirement and Benefits to provide more cost saving suggestions, and as recently as September, 2004, discussions occurred regarding using the Fund's \$80 million dollar Trust Account to pay off claims as they were submitted. He asked the Administrator and her staff to work with Department of Revenue staff to determine whether any of the Trust Account funds could be invested in a different manner to provide more revenue. No response was received and he had again made the request at a recent Board meeting. Following that, Alyce Hanley, a PERS Board Member, had asked the status of the Board's request to Aetna Insurance Company about cost saving measures. The Board declared that it "wanted some answers" about such things as cost savings and developed a follow-up schedule.

Mr. Wellington stressed that, while others might disagree, simply replacing Board members "is not the answer".

Mr. Wellington noted that the PERS Board has an upcoming scheduled meeting to address Appeals, and he did not support the proposal to move Appeals to the OAH. The current process provides more fairness. The Board "has no problem saying no if the facts warrant it".

10:40:18 AM

Senator Stedman stressed that there is no intent in this legislation "to deal with personalities on the Boards". No analytical work in this regard was conducted; the focus of the work delved into the structural working relationship between the Boards. "That is where the breakdown is". Even were Board members replaced, without a structural change occurring, the Funds would be "in the same position we have today". He acknowledged that the Boards have worked hard for many years.

Senator Stedman asked how much time the Boards were able to devote to reviewing the most recent Mercer actuarial report.

Mr. Wellington responded that the Board reviewed the material for approximately half a day.

Senator Stedman asked whether it was true that the presentation was rushed and was not finished.

Mr. Wellington thought otherwise, and stated that the Boards provide whatever time is deemed necessary to the presentation.

Senator Stedman understood that the Board devotes approximately 80-percent of its meeting time to addressing Appeals.

Mr. Wellington agreed.

Senator Stedman stated therefore the PERS/TRS Boards could be more appropriately characterized as an Appeals board.

Mr. Wellington pointed out that the Board addresses the work it is presented and that "a large percentage" of the work is in the form of Appeals.

Senator Stedman asked the percentage of Appeals the Board upholds or overturns.

Mr. Wellington understood that the Board's ratio is 50/50. The important thing is that after the Board provides its opinion, either side could appeal to the Superior Court. "Sometimes the State has and sometimes the appellant has". The most important thing to note is that the Board's decision is rarely overturned by the Superior Court. On occasion, the Court has asked the Board to re-evaluate a point of law on a specific "narrow" issue. The record of the Board is excellent.

Co-Chair Green clarified that the ALJ is appointed by the Governor and must be confirmed by the Legislature. It would not matter whether the ALJ was housed in the Department of Law, the Department of Administration, the Department of Health and Social Services, or the Department of Transportation and Public Facilities. "They are simply housed in the Department of Administration. They are not in the line of authority of the Department of Administration". It has been implied three times that this is a conflict ... that is just an unfounded very, very unfortunate accusation". This type of comment is not welcome again.

Mr. Wellington interjected that he had not implied any wrongdoing.

Co-Chair Green reiterated that no further comment implying "any conflict with a judicial system that is set up" would be tolerated. The ALJ is appointed by the Governor and confirmed by the Legislature, "and that is the line of authority".

The bill was HELD in Committee.

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**ADJOURNMENT**

Co-Chair Green adjourned the meeting at 10:44 AM.