

HOUSE FINANCE COMMITTEE  
February 5, 2009  
1:34 p.m.

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CALL TO ORDER

Co-Chair Stoltze called the House Finance Committee meeting to order at 1:34 p.m.

MEMBERS PRESENT

Representative Bill Stoltze, Co-Chair  
Representative Bill Thomas Jr., Vice-Chair  
Representative Allan Austerman  
Representative Harry Crawford  
Representative Anna Fairclough  
Representative Les Gara  
Representative Reggie Joule  
Representative Mike Kelly  
Representative Woodie Salmon

MEMBERS ABSENT

Representative Richard Foster  
Representative Mike Hawker, Co-Chair

ALSO PRESENT

Annette Kreitzer, Commissioner, Department of Administration; Pat Shier, Director, Division of Retirement and Benefits, Department of Administration; Jerry Burnett, Deputy Commissioner, Division of Treasury, Department of Revenue; Kevin Brooks, Deputy Commissioner, Department of Administration; Kathy Lea, Retirement Manager, Division of Retirement and Benefits, Department of Administration; Representative Carl Gatto

PRESENT VIA TELECONFERENCE

SUMMARY

HB 81 "An Act making appropriations for the operating and loan program expenses of state government, for certain programs, and to capitalize funds; making supplemental appropriations; and making appropriations under art. IX, sec. 17(c), Constitution of the State of Alaska; and providing for an effective date."

HB 81 was HEARD and HELD in Committee for further consideration.

HB 83 "An Act making appropriations for the operating and capital expenses of the state's integrated comprehensive mental health program; and providing for an effective date."

HB 83 was HEARD and HELD in Committee for further consideration.

[1:36:04 PM](#)

BUDGET OVERVIEW - PERS/TRS UPDATE

ANNETTE KREITZER, COMMISSIONER, DEPARTMENT OF ADMINISTRATION presented her staff and previewed the handouts for the committee (copies on file).

[1:39:34 PM](#)

Co-Chair Stoltze noted that the Department of Revenue was available for questions.

PAT SHIER, DIRECTOR, DIVISION OF RETIREMENT AND BENEFITS, DEPARTMENT OF ADMINISTRATION provided a PowerPoint presentation on the basic overview of the retirement system, State of Alaska, Public Employees' Retirement System, Teachers' Retirement System, Presentation to the House Finance Committee on PERS/TRS 2009 (copy on file). He reported on the history of PERS/TRS and on those who were covered by the system (page 2-3). He mentioned that the State of Alaska serves as both an employer and the entity, under SB125, that has agreed to pay a large portion of the unfunded liability. Mr. Shier explained that three governing boards had been consolidated into the Alaska Retirement Management Board (ARMB) (page 4). He named the plan categories in The PERS system, the Defined Benefit (DB) and the Defined Contribution Retirement (DCR) (page 5). He referred to the constitutional prohibition against diminishment of the retirement system in Article 12, section 7 of the Alaska constitution (page 6).

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Co-Chair Stoltze asked theoretically if future legislators did not fund the retirement system could the courts take money out of the permanent fund. Commissioner Kreitzer preferred not to give a legal opinion on the subject.

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Mr. Shier explained how the retirement system works (page 7). He elaborated that contributions to the system were from three sources, the employee, the employer and SB 125 (page 8). He broke down the employee contributions into the defined benefit (DB) and the defined contribution retirement (DCR-Hybrid) (page 9). Mr. Shier noted that employer contributions were defined at one adopted rate by the ARMB but the legislature capped employer rates lower therefore, the difference is now paid by the state (page 10).

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Representative Fairclough questioned how often the arbitrator reviews the employer contribution percentage. Mr. Shier replied that it is reviewed annually. Representative Fairclough asked for the current shortfall number. Commissioner Kreitzer responded it would be discussed later in the presentation.

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Mr. Shier remarked that the process in the ARMB adopted rate is based on 25 variables including the investment rate of return and assets value, life expectancy, payroll growth and future healthcare costs (page 11). He revealed that normal cost is the actuary's estimate of how much money to collect this year for only this year's benefit accrual. He noted that past service cost pays for the unfunded liability (page 12).

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Commissioner Kreitzer revealed the 2007 unfunded liability for PERS is \$4.6 billion and TRS is \$2.8 billion for a total of \$7.4 billion. She added that when factoring in the last calendar year losses it approaches \$9.4 billion.

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Representative Fairclough declared that the market is affecting long term projections. She understood that \$1 billion had already been put in the retirement system but asked for clarification if there was also tax financing. Representative Fairclough inquired if there were plans to buy down the debt, and if so, at what percent. Commissioner Kreitzer remarked that the state came close to issuing pension obligation bonds but chose not to take that action.

Representative Fairclough repeated what would be the trigger to issue state pension obligation bonds and at what percentage or cap would be used.

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Commissioner Kreitzer referred to Jerry Burnett. She added in reference to Representative Fairclough's first question of why is the fund still behind after adding \$1 billion she remarked that although there have been short term losses in the market; the board invests for the long term. Commissioner Kreitzer reported that historically good rates are returned in long term investment.

Co-Chair Stoltze asked if this was similar to a credit card bill out of control. Commissioner Kreitzer replied that is a short term versus long term view.

JERRY BURNETT, DEPUTY COMMISSIONER, DIVISION OF TREASURY, DEPARTMENT OF REVENUE answered that the targeted interest rate would be in the range of 5.5 to 6 percent with the actuarial rate of 8 percent. He did not want to speculate on a trigger target.

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Representative Fairclough expressed her delight that they were not in the market. She questioned if the 80 percent funding ratio would be determined by the administration. She wondered if the department was able to take the funding rate down further than 80 percent. Mr. Burnett replied that the legislation authorized up to \$5 billion in pension obligation bonds. He added that there have been no discussions that indicated any plans to go beyond \$2 billion.

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Representative Salmon wondered how the program had changed since enacting the bill for the defined contribution retirement. Commissioner Kreitzer replied that the state is making significant contributions above what is actuarially required to fund the system but she stressed that 75 percent of the money needed is from investments. The Commissioner noted that the down market had a significant impact on the value of the funds which is why the money is invested on a long term basis.

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Representative Salmon questioned if things were better or worse since passing the bill. Commissioner Kreitzer had no immediate answer during this overview meeting.

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Mr. Shier continued the presentation with another view of the ARMB adopted rate (p. 13). Commissioner Kreitzer interjected that this page shows again the state pays the difference in the ARMB adopted rate and the statutory rate.

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Representative Austerman asked if the 22 percent statutory rate was for all participants or just state employees. Commissioner Kreitzer answered it was for all participants not just Alaska state employees. Mr. Shier clarified that this is the same rate paid on all defined benefit and defined contribution retirement employees in the PERS system. Mr. Shier defined investments as assumptions and asset allocations (page 14). He remarked that determining the rate of return and life expectancy are considered assumptions. Asset allocations are the difference between how much of the fund is in stock, bonds, real estate and other choices for investments. He declared that assumptions and asset allocations are executed using a long-term view. Mr. Shier remarked that for the 2008 calendar year PERS losses amounted to 22.24 percent of the assets on hand; the DCR amounted to 35.46 percent. He signified that for PERS alone there was a calendar year decline in value of \$2.7 billion and for the DCR, a \$9.8 billion decline. Mr. Shier added that the DCR plan was newer and immature so the percentage is higher.

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Co-Chair Stoltze asked how much of the decline is based on the shorter time that defined contributions had been in play in the volatile market. Mr. Shier replied the market did play a part but hard to tell to what extent. Co-Chair Stoltze requested accurate statistics for greater understanding. Representative Kelly asked for the impact on the unfunded liability loss in the investment value on the defined benefit versus the defined contribution retirement. Mr. Shier replied that there is no affect on the unfunded liability from the losses in the DCR, all the losses came from the DB side.

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Mr. Shier stressed the need for the investment returns for cash flow because contributions alone would never be sufficient to make the required payments (page 15).

Representative Kelly remarked that "smoothing" is an accounting term but he did not think it described the hits in 2000 and 2008. He believed this could never be smoothed. Mr. Shier agreed that 5-year smoothing tries to fold in 20 percent at a time the effects of both extraordinary earnings and losses. He cautioned that it would be hard to predict how much over the 8.2 percent line it would be in the long term after these recent volatile times.

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Mr. Shier continued to Pay-Retirement incomes (page 16). He asserted that there were 32,500 retirees, 60 percent in the state of Alaska, 40 percent out of state. He noted that this translates into \$60 million per month in retiree income. Mr. Shier remarked that if you added health care it would be another \$25 million per month. He added that there are 26,000 dependents associated with the 32,500 retiree figure. Representative Austerman questioned if there is any statistical difference between the present retirees and new employees heading toward retirement or will it remain 32,500 forever. Mr. Shier warned that this plan is still very immature and the retiring population is growing.

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Representative Fairclough asked for a tier breakdown of the 32,500 retirees. Mr. Shier replied that the department is working on fact sheets that will include detailed information on the tier breakdown. He reported that the fact sheets would also be available on the ARMB website. Representative Fairclough commented that she was interested in knowing the tier breakdown numbers to see if this creates less liability and obligation for the state in the long run.

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Representative Joule wondered if those in the system who retired before the present PERS/TRS system were included in the 32,500 number. Mr. Shier responded that some retirees in the prior system, as well as those in the judicial system, were not included in the number.

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Mr. Shier referred to the PERS Funding Ratio History and the TRS Funding Ratio History graphs (copies on file). He mentioned that the funding ratio is a measurement of assets compared to liabilities. He alleged that during 2001-2002 there was a decline in the investment market (page 17). Before that time PERS/TRS enjoyed funding rates at or near 100 percent. He defined the term OPEB as "Other Post Employment Benefits." Mr. Shier remarked that Alaska is in good shape in this respect as the state has consistently

prefunding those liabilities where many other states have a pay-as-you-go philosophy. This is one of the fast growing components of the liabilities for the retirement fund. Commissioner Kreitzer interjected that OPEB equates to health costs. Mr. Shier remarked that trust funds were calling for significant additional contributions but because of limitations in law of only being able to put in 5 percent more. That restriction has since been removed. Mr. Shier remarked that the rates today are what the actuary indicates the trust fund needs this year to meet its obligations by paying down a 25 year mortgage on unfunded liability. Alaska's response was to create the DCR-Hybrid plan in SB 141, a new retirement plan plus a new employer-funded health benefit plan. This was followed by SB 123, a clean-up bill that allowed the system employers to assess all pay roll at the statutory 22 percent rate for PERS and 12.56 percent for TRS to assist in the pay down of the unfunded liability in future periods (page 19). Mr. Shier reiterated that SB 125 has the state of Alaska pay the difference between the statutory rate and the ARMB rate.

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Representative Austerman asked for a projection for 2008. Mr. Shier remarked that states around the United States are going to see some improvement in their condition because states started to respond to these economic circumstances in the early 2000. Mr. Shier added that because there is a lag time coupled with the 5-year smoothing it might be possible to see the improvement in the funding ratio although he believed it will be temporary.

KEVIN BROOKS, DEPUTY COMMISSIONER, DEPARTMENT OF ADMINISTRATION remarked that there were losses in calendar year 2008 but 2007 produced some significant returns. He reminded the legislators that the department takes a 25 year overview because despite the rise and falls, the market tends to level out over time.

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Representative Austerman asked if the prior 10 to 15 year level spread will be followed by 10 to 15 down years. Mr. Shier believed that to stay down that long should not be the goal of any retirement system but emphasized the importance of trying to get back to a higher level in any way possible. Representative Austerman wanted to know the reality of the situation. Mr. Brooks replied, the actuary determined rate, all things being equal, that if the contribution amount is equal to paying for normal costs as well as past service costs then over a 25 year period there should be an increase tending closer to 100 percent. He added there is no way of predicting future markets and health care costs but here are

25 assumptions that help the actuary arrive at a good estimate.

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Vice-Chair Thomas discussed a special teacher situation in his community.

KATHY LEA, RETIREMENT MANAGER, DIVISION OF RETIREMENT AND BENEFITS, DEPARTMENT OF ADMINISTRATION replied that when combining PERS and TRS time it is necessary to look at whether it is in reference to the DR or DCR. In the DR program there is a public service provision that would allow teaching time to be incorporated into the PERS system as long as the combined time equaled five years. She informed there is no provision for such a benefit in the DCR plan.

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Representative Joule wondered if the transferability was tied to being vested or not. Ms. Lea replied that for the public service benefit in the defined benefit plan it is not necessary to be vested in either one just the combined service has to equal five years. She added that there is a conditional service benefit plan that requires the recipient to be vested in one system and a minimum of two years of service in the other in order to be eligible for the benefits.

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REPRESENTATIVE CARL GATTO speculated on a theoretical PERS/TRS situation. Ms. Lea responded that in the defined benefits plan for the public service benefit it is specific to people who are not vested in either system. In the conditional service benefits, it is only necessary to be vested in one system and a minimum of two years of service in the other to be eligible for a benefit. The years are not combined but a benefit is received based on TRS service and salaries and PERS service, with the associated rules. Ms. Leas explained the only connection between the two is if the employee is vested TRS and the TRS salary is higher then PERS, then the TRS salary can be used to calculate the benefits.

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Vice-Chair Thomas asked when former Tier 1 employees who left service must return to work in order to get vested. Mr. Shier replied that a Tier 1 employee must refund contributions and return to service by June 30, 2010.

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Commissioner Kreitzer indicated that the department would be willing to come to individual offices to help provide more information. She mentioned that information is available on the department's website. Co-Chair Stoltze wondered how Alaska's situation would look if health care costs were removed from the ratio. Commissioner Kreitzer indicated that the department always looks if state comparisons are just for pensions or also include health care benefits.

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Representative Austerman commented that a retiring employee signs up for a different medical plan than the active plan. He noted there is a fee after retiring for the medical plan which is taken out of their retirement check. He continued that when the retiree reached the mandatory age for Medicare the fee remains the same even though the state only picks up a portion of the health costs. Mr. Shier noted that in earlier tiers there was system-paid health care. In this system, prior to Medicare, the state system picks up the entire premium amount. He continued that when the retiree reaches the age of 65, Medicare, by federal law, becomes the primary payer, but when looking long term, 60 percent or more of the entire health care spending will be for the post Medicare group. Representative Austerman wondered if the costs to retirees needed to be raised. Mr. Shier explained that the reference only applied to the system-paid coverage where there is no cost to the employees.

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Commissioner Kreitzer signified that the department's focus has been trying to find ways to control health care costs. Representative Austerman indicated that costs for later tier retirees can be significant.

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Representative Crawford projected that if an employee retires at 60 under the defined contribution and sets up retirement to last a certain amount of years, he wondered if the health care benefits would also cap out. Commissioner Kreitzer said health care benefits would continue. Mr. Shier reiterated that when the life of the annuity runs out, the health care benefits should continue. He noted in the defined contribution retiree health plan there is a ten percent premium that the retiree would have to continue to pay in order to receive the benefits. Representative Crawford asked ten percent of what. Commissioner Kreitzer replied ten percent of the annual costs of the monthly plan premium. He added that there is a substantial balance in the health reimbursement account which could be used to pay the

ten percent premium and the co-pays not covered in the plan. Representative Crawford asked if money for the health reimbursement account was being taken out of employees paychecks. Mr. Shier replied it is paid entirely by the employer.

Representative Kelly stated that he had been looking at the unfunded liability problem when it was \$4 billion and now it is around \$10 billion. He asked if the conversion to the new defined contribution plan help lessen the unfunded liability.

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Representative Kelly requested a careful response to his question be sent to the committee. Commissioner Kreitzer reported the information on the unfunded liability would not be available until next week.

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Representative Kelly commented that if the retirement system had been left as a defined benefit instead of moving to a defined contribution he wondered if that would have helped matters. Commissioner Kreitzer replied that SB 123 did allow the state to access all payrolls from all employees to pay down the unfunded liability. Representative Kelly reiterated that he wanted to know the comparisons between the defined benefit and the defined contributions system plans.

Mr. Brooks stated that the department's question to the actuary is to give an analysis of the unfunded liability not speculate if everyone had stayed in the deferred benefits program. He remarked it cost a lot of money to run these numbers. Representative Kelly responded that he would still like the answer to his question.

Representative Gatto asked if the employer picks up 100 percent of health care premiums once an employee retires. Mr. Shier responded that once an employee retires health care is paid for by the trust funds. Representative Gatto questioned if the state is required to make an additional contribution to health care when an employee reaches a certain age. Deputy Brooks said that when an employee retires prior to Medicare eligibility age the state covers the full premium cost, once they reach the age of 65 Medicare becomes the primary insurance and the state picks up the supplementary costs.

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ADJOURNMENT

The meeting was adjourned at 2:52 PM