

ALASKA STATE LEGISLATURE
HOUSE LABOR AND COMMERCE STANDING COMMITTEE

January 25, 2013

3:16 p.m.

MEMBERS PRESENT

Representative Kurt Olson, Chair
Representative Bob Herron
Representative Dan Saddler
Representative Andrew Josephson

MEMBERS ABSENT

Representative Lora Reinbold, Vice Chair
Representative Mike Chenault
Representative Charisse Millett

COMMITTEE CALENDAR

OVERVIEW: DEPARTMENT OF ADMINISTRATION

- HEARD

OVERVIEW: REGULATORY COMMISSION OF ALASKA

- HEARD

PREVIOUS COMMITTEE ACTION

No previous action to record

WITNESS REGISTER

BECKY HULTBERG, Commissioner
Department of Administration (DOA)
Juneau, Alaska

POSITION STATEMENT: Presented the Department of Administration's (DOA) overview.

MIKE BARNHILL, Deputy Commissioner
Department of Administration (DOA)
Juneau, Alaska

POSITION STATEMENT: Testified during the overview on the Department of Administration (DOA).

T.W. PATCH, Chair

Regulatory Commission of Alaska (RCA)
Department of Commerce, Community & Economic Development (DCCED)
Anchorage, Alaska

POSITION STATEMENT: Presented an overview of the Regulatory Commission of Alaska (RCA).

ACTION NARRATIVE

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CHAIR KURT OLSON called the House Labor and Commerce Standing Committee meeting to order at 3:16 p.m. Representatives Josephson, Herron, Saddler and Olson were present at the call to order.

Overview: Department of Administration

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CHAIR OLSON announced that the first order of business would be an overview by the Department of Administration.

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BECKY HULTBERG, Commissioner, Department of Administration (DOA), stated that the DOA is a complex department. She referred to the organization chart of divisions and independent agencies, noting one core department function is to provide business support services to state agencies and to the public. She related the department is evenly divided between the two. She pointed out the department has a number of independent boards and commissions, including the Violent Crimes Compensation Board (VCCB), the Alaska Oil & Gas Conservation Commission (AOGCC), the Alaska Public Offices Commission (APOC), the Alaska Public Broadcasting Commission (APBC), and the Office of Administrative Hearings (OAH), which is an independent body that hears administrative appeals. She stated the DOA has core offices in Anchorage, Fairbanks, and Juneau, but maintains a statewide presence offering services through the Division of Motor Vehicles (DMV), the Office of Public Advocacy (OPA), and the Public Defender Agency (PDA) [slide 3]. She reported the FY 13 staff figures, including a total of 1,145 employees, with 1,087 fulltime, 18 part-time, and 40 non-permanent employees. She said the budget is approximately \$335 million this year.

COMMISSIONER HULTBERG provided the DOA's "Strategic Plan Highlights" [slide 4]. She stated the DOA's mission is to

provide consistent and efficient support services for state agencies. She reported the department has undergone an internal strategic planning process and has developed four department goals: to provide excellent customer service, reduce the rate of spending growth to sustainable levels, and provide efficient delivery of services, and encourage employee development and provide employee support.

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COMMISSIONER HULTBERG turned to "Department Level Results" [slide 5]. She stated the five-year trend in expenditures has been growing at a smaller and smaller rate. In 2009 the department was growing at a 5.75 percent rate of growth, whereas this past year had a 2.41 percent growth rate. She alluded to challenges outside the DOA's control this year that may impact the growth rate of expenditures. She referred to the core growth of personal services, which was 5.45 percent. She explained that the personal services component represents the largest component of expenditures for most departments. In conclusion, since the DOA's rate has fallen to 2.41 percent, it means that the DOA is finding efficiencies or other ways to transfer money into personal services.

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COMMISSIONER HULTBERG described the "Services to the Public" [slide 6]. She identified Amy Erickson as the new DMV director. She pointed out numerous positive changes have occurred at the DMV, including that customer service has improved in the past several years; however, it can continue to improve. She highlighted technology initiatives for the DMV, including drivers' licensing and identification security, and knowledge-testing system replacement.

COMMISSIONER HULTBERG noted the role of the Public Defender Agency (PDA) is to uphold the rights of the accused, which represents an important constitutional principle. She stated the state can also step in through the Office of Public Advocacy (OPA) to provide counsel in instances in which the public defender has a conflict, but the office also manages the Court Appointed Special Advocate (CASA) program and the public guardian program, including the guardian ad litem program. At this time she highlighted she did not anticipate requesting any supplemental funding for the two agencies: the PDA and OPA. She reported if so, it will be the first time in its history the PDA does not require any supplemental funding.

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REPRESENTATIVE JOSEPHSON noted the [Department of Law's Criminal Division] prosecutor's office has asked for increases in funding. He asked whether the DOA would be requesting any increases in funding for the PDA since the system tends to work best when the funding for the PDA and the prosecuting office is balanced.

COMMISSIONER HULTBERG answered the DOA will monitor closely the resources for the public defenders and prosecutors. She said the DOA wants to work within its budget, philosophically, which is why the department is not planning to request any supplemental funding for the PDA; however, she said that doesn't mean there won't be an increment in the FY 14 budget.

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REPRESENTATIVE SADDLER said he had some experience with the DMV's computer system, which is not the most up-to-date system. He asked the commissioner to generally address the DOA's information technology (IT) resources.

COMMISSIONER HULTBERG answered that the department has a multi-year plan to replace the core DMV system and add new functionality. She reiterated the core system would be replaced, but over time the DMV will also add some functionality that the insurance companies need, such as "real-time" records. She added the process will take time. In further response, she clarified the insurance companies need crash information transmitted. In response to a further question, she said the department has two significant IT projects: the Core Enterprise Technology Services, which provides telecommunications, network services, and main-frame computer services for the state as an enterprise; and the Integrated Resource Information System (IRIS) project, which is a project to replace the legacy accounting and payroll systems. She described IT within the divisions as being decentralized, but noted the two broad projects will affect nearly everyone. Thus, the DOA's divisions have planned separate IT projects, including that the DMV has a significant IT project, Personnel [and Labor Relations] has a Workplace Alaska replacement project, and the Division of Retirement and Benefits (DRB) also has one planned.

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COMMISSIONER HULTBERG turned to "Services to State Agencies" [slide 7]. She characterized the DOA as paying wages to its employees, who perform tasks. Consequently, the DOA must negotiate labor agreements, manage health care, and provide for retirement and benefits for its employees. Further, she related the department also provides its staff with IT services, commodities such as office furniture and supplies, as well as insurance, office and lease space. She offered to discuss each area to discuss how the department plans to contain and manage costs, which ultimately are borne by all state agencies.

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COMMISSIONER HULTBERG related the historic rate of personal services has been level at 5.45 percent a year since 2006 [slide 8]. She explained that personal services includes negotiated cost of living allowances (COLA), negotiated and statutory merit increase and pay increments, plus increases in employer-paid health insurance premiums. Retirement contributions are also made by the state, she said. She pointed out the list of state employees by bargaining unit on the slide, including exempt and partially-exempt employees. She noted that agencies are typically funded to cover the negotiated COLA and increases for health care premiums; however, appropriations are not made for merit increases. She highlighted that a state employee typically is hired at the "A" step, receives a 3.5 percent increase annually through the "F" step, and subsequently receive a 3.75 percent increase at the "G" step every other year into perpetuity.

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REPRESENTATIVE SADDLER asked whether it is possible to eliminate state employees' raises or if it depends on negotiated contracts.

COMMISSIONER HULTBERG answered the primary source of pay increases is by negotiated contracts. She stated that merit increases and the pay increment system is not typically "on the table" in bargaining sessions, but the increases represent part of the basic compensation packet for employees. She said it doesn't mean these items can't be considered, but in past years merit increases and pay increments have not been considered. Further, she pointed out exempt and partially-exempt employee increases are statutory requirements. She emphasized the necessity for employers to keep all employees on the same pay structure. She highlighted that typically three state contracts

are negotiated each year and the department is currently negotiating the general government, supervisory unit, and confidential employees, which include the human resource employees and a few others. In further response to a question, she said the contracts typically cover three years in length and are staggered since it takes substantial manpower to negotiate the agreements.

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COMMISSIONER HULTBERG discussed "Benefits," including the state's contributions to active employee health plans [slide 9]. She said the bar chart shows the increase in the employer portion of the premium for employee health plans, noting not all employees are covered under the Alaska Care's active plan. The state funds four union health trusts, but the unions cover their employee's health insurance with contributions. She listed the union health trusts as Alaska State Employees Association (ASEA), the Long-term Care (LTC) 51 Health Trust, the Public Safety Employees Association (PSEA), and Masters, Mates & Pilots (MM&P) Health Trust. She emphasized that the employer's contribution rates keep climbing, noting the state funds 100 percent of the basic premium for a family economy plan. She pointed out Alaska is only one of seven states that pay one hundred percent of the basic premium plan. She highlighted that the escalation of costs is of significant concern the department. Thus, the DOA has developed strategies to control costs.

COMMISSIONER HULTBERG said retirees are covered by the Alaska Constitution's diminishment clause and these benefits cannot be changed as the insurance market changes. The court has interpreted that the dollar amount of the retirees' contribution is subject to the diminishment clause, which makes it very difficult for the state to change benefits. Essentially, this means the retirees' plan is increasingly valuable since the department cannot adjust the deductible or copay over time, she said. She highlighted that essentially what was once an "80/20" plan is now a "95/5" plan. She listed some benefits not included in the retiree plan, such as dependent coverage to age 26, or preventive care. While the department does not disagree with the coverage, as commissioner, she is reluctant to add costs to a plan that cannot be later removed without providing an offsetting enhancement. Currently, the liability associated with state retirees is a \$4 billion health care liability, which is part of the overall \$12 billion in liability costs. She acknowledged that plan changes are possible, and one option is

to litigate, whereas another choice is to create an optional retirees' plan that retirees can opt into. The department decided to create an optional retirees' plan, which is in draft form. She reported that the DOA's actuary is currently reviewing the optional retirees' plan. She offered to discuss enhancements and cost-savings under the proposed retirees' plan at some point.

CHAIR OLSON advised new members that colorectal cancer screening set off the debate last year.

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COMMISSIONER HULTBERG turned to "Business Processes" [slide 10]. She said the Integrated Resources Information System (IRIS) Project is the replacement of the core accounting and payroll system. She added IRIS will provide human resources and procurement functionality at an enterprise level for the state. She characterized this as a significant IT project for the entire state and will affect everyone, in particular, in the way that accounting and procurement jobs are performed.

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COMMISSIONER HULTBERG turned to "Space Costs" [slide 11]. She referred to the graph, which depicts the ever increasing costs for leases. She highlighted two components contributing to the cost growth. First, one component of cost increases has been due to the inflation of leases. Secondly, agencies typically have needed more space over time. She explained the DOA has little direct control over the costs since leases are typically performed through a request for proposal (RFP) process and the department selects the most competitive respondent; however, the DOA can ensure that its space is used effectively. She said the department just implemented universal space standards modeled on private sector standards [slide 12]. She related the square footage per employee will shrink; however, the state will offset this by also limiting the number of private offices and by moving offices from exterior walls. She concluded this will result in lighter spaces and "neighborhood" should enhance collaboration and teamwork. She pointed out private meeting spaces will be available for employees to use. She highlighted the conservative estimate is that the state will save \$125 million over a twenty-year timeframe.

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COMMISSIONER HULTBERG turned to "Purchasing" [slide 13]. She said most purchasing is done at the department level, although the department has enterprise-level agreements and manages for bulk purchases. She pointed out some of the savings listed on slide 13, including \$11,991,321 in software savings and \$7,123,706 in savings for computers, printers, and peripherals.

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COMMISSIONER HULTBERG turned to "IT Services" [slide 14]. She said this slide identifies the six enterprise technology services priorities, including bandwidth, security, mobile device strategy & support, continuity of operations, identity management, and experienced-based rate-setting and rate-setting alignment with budget process. She emphasized the DOA wants to ensure its rate structure is fair, makes sense, and aligns agencies' costs.

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COMMISSIONER HULTBERG, in response to a question from Representative Saddler, said she would need to research the baseline year of comparison on purchasing [slide 12], but she believed the savings represents what the state would have spent if it did not have the contracts in place for the current fiscal year.

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COMMISSIONER HULTBERG turned to "Insurance and Injury: Risk Management" [slide 15]. She pointed out the Division of Risk Management (DRM) has a significant budget. This division provides property insurance and has responsibility for workers' compensation. She highlighted that often the DRM expenses exceeds its authorization since the agency has a catastrophic reserve fund, which allows the risk management section to pay claims when necessary. She stated the fund was about \$5 million; however, in FY 12 the bulk of the fund was expended. She advised that the DOA will request funds for risk management since the agency has exhausted its reserve.

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REPRESENTATIVE HERRON identified slips and falls as the major reason for injury for public and private sector employees. He asked the commissioner to evaluate the department's response to

assist employees in returning to work, and identify whether the DOA is aggressive or somewhat aggressive in its efforts.

COMMISSIONER HULTBERG responded the DOA could be more proactive in preventing some workplace injuries. She acknowledged the DOA has identified the need to develop a return to work program, which is not currently available. She highlighted that the department encourages workers to come back to work, but when a person can no longer perform his/her job the DOA does not have a specific program to assist him/her. She indicated the department is conscious of this and an opportunity exists to become a bit more proactive.

REPRESENTATIVE HERRON agreed. He reported that the Alaska Public Entity Insurance (APEI) and Alaska Municipal League Joint Insurance Association Inc. (AMLJIA) have found organizations that "hold the employee's hand" from time of injury until the time they get back to work accrue cost savings. Additionally, he pointed out the longer employees are off the less likely they will return to work. He referred to slide 4, and asked for clarification on a spending growth reduction strategy.

COMMISSIONER HULTBERG answered the Division of Retirement and Benefits (DRB) anticipates a huge influx of new retirees since "baby boomers" are beginning to retire. The DOA recognizes the volume will increase so if the department continues to provide the same services, it will be necessary to hire more people or with better processes. Thus, the division has reorganized and is currently using operational excellence tools to identify processes and remove waste. She reported she learned today one process can be done in 50 percent less time. She concluded that actions like finding efficiencies will help the department meet the growing demand using the same resources and without hiring additional staff.

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REPRESENTATIVE JOSEPHSON referred to the DOA's decision not to provide health care services for dependents up to age 26 on retirees' plans. He understood this was not an option due to the diminishment clause, but he asked for further clarification.

COMMISSIONER HULTBERG said retirement plans are not covered by the Patient Protection and Affordable Care Act (PPACA), which mandates dependent coverage up to the age of 26. The active plan is grandfathered under the PPACA, but is still subject to the act, she said. While the active plan extends coverage for

dependents up to the age of 26, the retirees' plan is not subject to the act. She surmised the intent was to avoid adding additional coverage into retiree plans since some employers were dropping retiree plans altogether. She explained that the state's retirement plan is constitutionally protected; however, the state is not required to add the dependent coverage. She cautioned adding dependents would add additional costs and the state is hesitant to do so. In response to Representative Josephson, Commissioner Hultberg offered to provide figures for the cost of covering retiree's youth, including whether it would be under \$10 million.

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REPRESENTATIVE JOSEPHSON further asked whether the department has a position about a conceptual defined benefit bill. He related a scenario in which all parties agree the cost to implement a new defined benefit bill would not be more costly than the existing defined contribution plan. He inquired as to whether the department has other concerns besides cost.

COMMISSIONER HULTBERG deferred to Mike Barnhill; however, she asked for clarification on the determination that a plan will not cost more. She said a benefit plan does not start with a built-in unfunded liability, but the employer assumes the risk that an unfunded liability could develop in a defined benefit plan. Even though a plan does not initially identify an unfunded liability or that a plan is self-sustaining or less costly from an operational standpoint, will not insulate the state from a future unfunded liability.

CHAIR OLSON remarked some people who have indicated a proposed new defined benefit plan will not incur cost increases may be the same ones that got the state "into the mess" six or seven years ago when the state's retirement plan was converted. He identified the issue can arise with interest rates, using the wrong mortality table, or making other erroneous assumptions. He suggested the vote the legislature made with respect to the conversion was difficult to make, but he offered his belief it was the right thing to do. He acknowledged an unfunded liability currently exists in Alaska. However, he noted other states have followed suit, but also made drastic changes, such as Rhode Island, whose plan changes affected not only its current members, but retirees, too.

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REPRESENTATIVE JOSEPHSON raised options to address the unfunded liability, including whether the legislature should move \$11 billion from the constitutional budget reserve (CBR) to the Public Employees Retirement System (PERS) and the Teachers Retirement System (TRS) and end the problem. He identified another approach the legislature could take would be to appropriate \$600 million now and amortize it over time. He asked for clarification.

COMMISSIONER HULTBERG said a fundamental balancing act exists between paying off a liability and ensuring budget flexibility to meet all of the other needs of Alaska's citizens, such as schools, roads, and public safety, plus make the actuarially required contributions to manage the state's liability. She asked whether the state would be wise to do so. She said if the price of oil falls to \$40 per barrel next year that the state may need some of those savings to "help keep the lights on."

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MIKE BARNHILL, Deputy Commissioner, Department of Administration (DOA), related historically the DOA provides this type of an overview on the retirement system to the finance committees at the beginning of the legislative session. He began his PowerPoint presentation on "Special Focus: Retirement Funds and Health Care Plans" by discussing membership statistics, focusing on the active membership percentage remaining in the defined benefit plan and what percentage is now in the defined contribution plan. He explained the state has been stuck at 75/25 percent split between defined benefit and defined contribution members. According to the draft FY 12 actuarial evaluation the defined contribution population has now increased to 31 percent, he said.

MR. BARNHILL reported the Teachers Retirement System (TRS) is comprised of 73 percent active employees and 27 percent defined contribution employees. In 2005, the legislature passed Senate Bill 141, which closed the defined benefits plan to new employees beginning on July 1, 2006. Over time, the active plan will consist solely of defined contribution members. He explained the process, that once the fiscal year closes the actuaries begin work and typically provide a draft valuation by the end of December or early January. While the DOA has the new figures, the figures have not yet been reviewed. In 2006, legislation required a second actuary must review the valuation figures before presenting them to the Alaska Retirement Management Board (ARM Board). He advised that this process has

not yet begun or is barely underway. He anticipated the figures will be presented to the ARM Board in April 2013 and final action will happen in late spring or possibly in early summer. He referred to "PERS/TRS Basic Facts" [slide 19]. He stated the unfunded liability has grown to \$11.832 billion which is related to investment returns of approximately .5 percent. He related one of the actuarial assumptions is a return of 8 percent per year; however, the actuarial return assumption was missed by a fairly large margin.

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MR. BARNHILL noted the funding ratio has fundamentally decreased so for PERS, which is funded at 61.3 percent and TRS, which is funded at 52.1 percent. Typically, an actuary would consider a healthy plan one that has 100 percent of its assets, and 80 percent is considered a healthy metric in an open plan. Of course, the state would like its rates to increase to 80 percent, the investment markets to return, and ratios to improve since these are not particularly healthy numbers, he said.

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MR. BARNHILL turned to the "TRS Basic Facts" "Health Cost Trends" [slide 20], noting health costs is one reason for unfunded liabilities. He pointed out this slide indicates the premiums cost changes since 1977. Over the long term the compound annual increase has been at 9 percent while over the short term health care costs have flattened out over several years resulting in low single-digit growth. This has been a consistent long-term pattern: with sharp increases, followed by a plateau for a few years, and then rates climbing sharply again. He indicated this is evident in 2004-2008, with a sharp increase reflected for 2010-2011. During the periods of sharp increases, the department works to flatten out the rate so the long-term annual cost growth rate is closer to the rate of inflation or inflation plus two or three percent, he said.

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MR. BARNHILL reported the actuaries' health cost growth assumption for the next 30 to 40 years is calculated at 6 percent per year. In short, if the state can beat this rate it will help reduce the state's unfunded liability associated with health care. He reported the PERS and TRS unfunded liability, associated with health care, has risen to \$4.1 billion. Even though the overall unfunded liability has increased, most of it

is a product of pensions and not due to health costs. He referred to the history of PERS and TRS funding ratio [slides 21-22]. Currently, at 61 percent, the state's funding ratio has fallen to an all-time low in the history of PERS, which is a product of poor investment returns. He reported from the mid-1990s until 2002, the unfunded status represents misreporting during this period since the actuaries underreported, the state under contributed, and undercollected from employers. He recapped that the state did not collect enough and the state continues to pay the price.

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REPRESENTATIVE JOSEPHSON asked whether the Congresses' proposal to extend the eligibility age to 67 for Medicare coverage would undermine the state's efforts. He characterized the potential federal action as "a bad thing" for the state.

MR. BARNHILL acknowledged it would be bad for the state since it will expand the gap for health care coverage between the Tier I normal retirement age of 55 and the Tier III retirement age at 60. He explained a gap currently exists between retirement at age 60 and the Medicare eligible age of 65. He agreed if the Congress increases Medicare eligibility to 67, with no change in the retirement plan, it would result in a coverage gap that could potentially expand forever.

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CHAIR OLSON remarked that the actuaries' actions were so egregious they settled out of court for \$500 million rather than go to trial.

MR. BARNHILL agreed the settlement was put into the health trust funds for PERS and TRS. He said two of the state's actuaries were given a three-year suspension by their governing organizations.

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MR. BARNHILL turned to "Contribution Rates" [slide 23]. In the early 2000s, the state had relatively low contribution rates, which was a product of underreporting, under collecting, and poor projections on health care cost growth. In FY 02, the state discovered problems with the actuaries' valuation. In 2004, an unfunded liability of over \$4 billion was disclosed. As a result, the retirement boards struggled with the unfunded

liability, but ultimately decided not to set the contribution rate to the full amount; instead, the boards let that rate grow. From 2004-2007, the contribution rate was set at five percent a year rather use the full rate. At the time, the legislature sunsetted the boards and replaced them with the ARM Board, which has always set the rates at the full actuarial rate. In 2007, rates spiked to over 50 percent for TRS and over 30 percent for PERS, which created a problem for the legislature since political subdivisions and school districts must also pay those rates, too. In fact, when contributions to a pension system are in excess of 50 percent of the payroll, the burden could tip a school district or political subdivision into potential bankruptcy. Thus, the legislature immediately acted. In 2007, the legislature appropriated funds to buy down the rates, and in 2008, the legislature passed Senate Bill 125 to cap the rate at 22 percent for political subdivisions and 12.56 percent for school districts. He concluded that this provided fairly generous relief to school districts, although he believed it was a fairly unusual action to take in the U.S.

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MR. BARNHILL reported some states and cities were not able to pay their unfunded liability and filed for bankruptcy, such as Alabama, Rhode Island, and Pennsylvania and the City of San Bernardino, California. In 2007-2008, the markets returned in and the improved investment returns reduced rates. In 2009, markets crashed once again and rates began to increase, he said. Currently, the DOA now has 2014 rates as well as the draft proposed 2015 rates, noting a three-year rate setting lag exists. Thus, he advised the valuation for 2012 will set the 2015 rates, which is estimated at over 60 percent for TRS and 40 percent for PERS. He remarked these rates are the highest the system has ever seen. Since 2008, the state has contributed over \$2 billion in total to school districts and participants in PERS. The lion's share of this assistance - \$600 million - has gone to the state as employer. The \$1.4 billion in state assistance to school districts and political subdivisions represents an extraordinary amount of assistance. Looking forward, the governor has put in the FY 14 budget - in the language section - a request for an additional \$630 million, he said.

MR. BARNHILL emphasized the ARM Board instituted a methodology change. He characterized an unfunded liability as a debt that is amortized over time, such as a house mortgage. The payments are the same each year, which is considered "a level-dollar

amortization." The ARM board adopted a different structure, a "level-percentage of pay amortization," which is back-loaded. Consequently, annual payments will go up correspondent with growth in payroll. The ARM board used four percent per year growth as an assumption for payroll. All things being equal, he predicted the unfunded liability will likely continue to grow at four percent per year. He reported the level dollar amortization as more front-loaded and a level-percentage of pay amortization as back-loaded or one that pays more at the end. Until FY 14, the amounts were calculated on a level percentage of pay amortization methodology, although the ARM Board just adopted a level-dollar amortization methodology. This invites the legislature to appropriate more funds for state assistance earlier rather than to back-load it, he said.

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MR. BARNHILL turned to the "PERS/TRS GF State Assistance (SB125) [slide 24]." In FY 15, the PERS/TERS general fund state assistance amounts jumped sharply from \$600 million to over \$1 billion, noting these projections are based on the FY 11 valuation. He hoped that projections for FY 12 would be available next week, although he did not anticipate any financial improvements. He noted the ARM Board is essentially inviting the legislature to accelerate payments in the form of state assistance with payments cresting over \$1 billion in FY 16 and trending down until the unfunded liability is fully amortized, based on a 20-year amortization. In FY 2030, the state would be able to fully amortize the initial unfunded liability that arose in the FY 02 evaluation, he said.

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REPRESENTATIVE JOSEPHSON related his understanding in 2007-2008, the legislature took action to ease the burden on political subdivisions. He suggested it appears as though it may be necessary to do so again.

MR. BARNHILL said the result of capping rates was that someone must pay: the school districts, the political subdivisions, or the state. The graph shows the amounts paid by the state, which represents the difference between the actuarial rate at 22 percent and real rate for PERS at 12.5 percent, plus the real rate for the TRS [slide 23].

REPRESENTATIVE JOSEPHSON asked the reason the maximum rate for PERS is set at 22 percent, but the TRS rate is only set at 12.5 percent.

MR. BARNHILL answered the 22 percent was a negotiated figure.

CHAIR OLSON recalled the percentage was arrived at to keep some smaller cities and school districts from "going belly up." He further recalled it was an arbitrary number.

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MR. BARNHILL agreed the PERS rate was arbitrary; however he advised the TRS rate was based on the actuarial projection for the normal cost for the system, in the valuation before the legislature at the time. He offered to discuss the different components of cost. He identified the normal cost rate as the amount an employer will contribute to the system if all of the actuarial assumptions are accurate. He reported adjustments are always necessary and any adjustment falls under past service cost rates. In this instance, 12.5 percent was the normal cost rate for the TRS, he said. The legislature decided that the state would pick up the entire past service costs for school districts and share it with political subdivisions. He pointed out the graph represents the amounts the ARM Board would like the legislature to appropriate over the next 20 years. The state used the level percentage of pay methodology and the bars trend up over time; however, in the short term it is closer to the amount the state historically has paid.

MR. BARNHILL referred to "PERS/TRS GF State Assistance" [slide 24]. Despite what ARM board recommends, the legislature still retains the power of appropriation, he advised. At the same time, a variety of ways exist to pay off the debt ranging from Representative Josephson's suggestion to pay it all off to some financing or amortization plan. As an aside, last year the state and the ARM Board considered dozens of ways to finance the debt. Naturally, the more that the state pays now, the less it will need to pay later, he said. Under a level percentage of pay the state will pay more over time; however, in doing so the state may have ability to manage short term obligations. In conclusion, the legislature and the governor will need to decide the best approach, he said.

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MR. BARNHILL turned to the "Projected Retirement Population Growth" [slide 25]. He noted between the two systems the state expects retirees to grow to 60,000 by end of the decade. Consequently, he said this will put pressure on the DRB to process and administer a larger retiree population. Further, retirees will receive benefit payments and submit health care claims, which will put some additional pressure on cash flow. Additionally, the cash flow demands will potentially impact the rates of return and asset allocation must be considered.

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REPRESENTATIVE JOSEPHSON asked whether survivor benefits cover the department's projections, in other words in instances in which the retirees predecease their spouses.

MR. BARNHILL responded that the money flows out, but nothing helps administer the system.

REPRESENTATIVE JOSEPHSON pointed out that retirees pay a premium for selecting survivor benefits.

MR. BARNHILL answered the premium is not held back, but he offered to check with the DRB and provide the committee with exactly how that cash flow works.

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MR. BARNHILL turned to "Benefits: PERS/TRS" [slide 26]. One way to consider the unfunded liability would be to consider the net present value (NPV) and the figure will increase or decrease depending on the assumptions used. Thus, by using an earnings assumption of 8.5 percent, the estimated unfunded liability will decrease to less than \$10 billion, but using a lower earnings assumption, such as 5 percent, the estimated unfunded liability will increase to over \$20 billion. He directed attention to nominal dollar payouts over time, which he referred to as the "hard liabilities" the system must meet. He said, "We have to make these payments per the constitution. These folks have earned these benefits. They must be paid." The department has asked its actuaries to give the state the full projection since the system is closed and most of the retirees will have passed away by 2080, he said. He related the department is interested in identifying demands for cash between now and 2080. He reported the current cash flow at \$1.5 billion; however, this will increase to \$3.5 billion by 2040 and "grades down" until 2080. Accordingly, the demands on the system will be over \$3

billion per year for a period of over 20 years. He expressed his concern with the defined benefits system since unfunded liabilities can arise at any time. Thus, missing the assumption - eight percent - for a couple of years could translate into additional unfunded liability. Historically, he related, business cycles come and go and the state earnings fluctuate dramatically, as well. Since it isn't possible to predict additional unfunded liabilities or shortfalls may happen he has focused on the 20-year period in which the system will need \$3 billion per year.

MR. BARNHILL suggested members keep in mind the unfunded liability and unpredictable cycles as the legislature considers whether to go back to a defined benefit plan, along with any risks that such a decision might pose, and how the state will manage its cash flow.

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REPRESENTATIVE SADDLER asked if Mr. Barnhill would comment on a hybrid retirement plan, which would consist of a part defined benefit and part defined contribution plan.

MR. BARNHILL responded that a bill was introduced in the Senate this week; however it is identical to a bill that passed the Senate last year, Senate Bill 121. He said the administration opposed the bill last year and will continue to oppose any pure defined benefit plan. He pointed out some other states have experimented with alternatives to defined benefits, which they called hybrids. The administration would be willing to entertain the discussion so long as the state is protected from the type of unfunded liability that has arisen with the current plans, he said. Further, the state would also be willing to consider other retirement plan; however, the DOA's concern with any defined benefit plan is that these plans do not provide a secure retirement. Lastly, other states, such as Colorado, Rhode Island, South Dakota, and Minnesota have cut benefits to current retirees, which the administration believes is unfair, he said.

MR. BARNHILL, in response to a comment, agreed some states have also cut benefits to current employees. For example, it might not be fair to shut the library so a retiree can get a full pension, he said. Further, it wouldn't be fair cut teachers' salaries either and the administration wants to avoid doing so. On response to a question on trends, Mr. Barnhill said the state is unquestionably a leader in terms of its decision to move from

a defined benefits plan. He said most states have considered hybrids or are keeping their plan open and he credited former Governor Frank Murkowski for having taken action to address the issue.

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REPRESENTATIVE JOSEPHSON acknowledged he is alarmed by what he sees; however, the overview points to rising health care costs, including premiums increasing in cost from \$500 to \$1,300 in twelve years. He asked whether a proposal to omit retiree health care could be a starting point to make Tier V more solvent.

MR. BARNHILL predicted the administration would likely oppose any pure defined benefit proposal. He acknowledged a problem with health care costs exists, but the unfunded liability also relates to investment returns. In fact, when an employer is responsible for making the plan whole, but investment returns stagnate over time, the result is an unfunded liability, he said. Thus, the solution is to look beyond pure defined benefits to equitable risk sharing and creative alternatives similar to ones adopted by other states. He concluded his presentation by stating that he is proud of what Alaska has done since it has not cut benefits or "changed the deal" for its defined benefits' retirees.

Overview: Regulatory Commission of Alaska

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CHAIR OLSON announced that the final order of business would be an Overview by the Regulatory Commission of Alaska (RCA).

[4:29:12 PM](#)

T.W. PATCH, Chair, Regulatory Commission of Alaska (RCA), Department of Commerce, Community & Economic Development (DCCED), stated some aspect of the RCA's activities touches every Alaskan each day of the year. He said everyone at the RCA works to ensure safe, reliable, reasonably continuous, just and reasonably-priced utility service is available to Alaskans. He commended Commissioner Hultberg's observation that the state may need "cash to keep the lights on." In essence, he related, this is a concern the RCA attends to every day.

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MR. PATCH asked members to pose questions. He hoped members had already received a copy of the DCCED's budget overview and the RCA's annual report. He characterized his comments today as being general and not providing a detailed financial report of the RCA.

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MR. PATCH described his workday for members in an effort to illustrate his wide-ranging duties. He stated his day, including that he prepared for a conference in Washington D.C., handled matters re the Naknek Electric Association's bankruptcy, requested grant funding, and interacted with the Federal Energy Regulatory Commission's (FERC) staff on its decision to allow Hawaii's to import liquefied natural gas (LNG). Additionally, he edited correspondence to the governor on a request and fielded calls, including one from President Jones of the National Association of Regulatory Utility Commission about an upcoming conference and to accept a potential appointment to the National Regulatory Research Institute. Further, he said he assisted procuring an appointment for Bob Pickett to a subcommittee on Liquefied Natural Gas (LNG) exports, attended an RCA staff meeting, prepared for and attended a hearing related to the Chugach Electric Association (CEA), Matanuska Electric Association (MEA), Golden Valley Association (GVA), Enstar, and Matanuska-Susitna Electric Association (MEA), which also included the attorney general. He highlighted the matter is complex and was not resolved, but is on a positive track and may afford CEA and GVE some savings to members. He then edited and reviewed orders, notices, and letter orders. Next, he conferred with the executive director of the Alaska Telephone Association (ATA) on several matters. Finally, he related he is attending this hearing and will finish his day by packing his briefcase for weekend reading.

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MR. PATCH decided to use numbers to illustrate and conveying his overview of the RCA, similar to what he did during his presentation last year. He said numbers can represent dollars, dollars are often paid as rates, and rates for service translate to utility company billings. He said he asked the Legislative Budget and Audit Committee (LB&A) to allow the RCA an eight-year extension. The RCA's last sunset review was in 2011, and although the LB&A recommended an eight-year extension, the legislature only granted the RCA a three-year extension until

2014. He identified some current staffing issues, noting the RCA has four commissioners, but RCA's Commissioner Kate Giard, resigned effective January 4, 2013. He reported the governor is currently considering appointees and he hopes to make an appointment soon.

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MR. PATCH pointed out the number "\$500 million" as a number often discussed. For example, \$500 million is the amount the state authorized for the Alaska Gasline Inducement Act (AGIA) process. He characterized it as a significant figure and related it to a utility perspective. He related that one Southcentral Electric Utility indicated it will spend \$460 million over the next four years for necessary distribution system improvements and other capital projects related to reliable service and two utilities anticipate combined spending of approximately \$563 million for electric services to meet adequate generation needs. However, these utilities do not have 700,000 ratepayers to apportion the costs, as the state does, since it can apportion its AGIA costs to its residents.

MR. PATCH turned to the "number one". He explained that "one kilowatt" is the energy consumed by 17 60-watt light bulbs. Further, he related that leaving the aforementioned lights on for "one" continuous hour would result in "one" kilowatt hour listed on an electric utility bill.

MR. PATCH said next year he hopes to quantify "one billion," in terms of a billion cubic feet of gas and what that might look like.

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MR. PATCH identified some significant issues for the RCA. The RCA has arranged to host a cyber-security conference this summer. He related that some utilities have convinced him their systems have been attacked and the RCA will study and address the issues related to cyber-security.

MR. PATCH indicated the state obtained a favorable long-term credit rating from the Fitch Group, a national rating service and the governor and legislature should be proud of this rating. A number of larger utilities reported they also have received positive ratings from their rating agencies as they seek capital borrowing. He concluded that he is proud when a utility

president believes the RCA has had a positive influence on a company's credit rating.

MR. PATCH emphasized that rural infrastructure concerns him, whether it is the cost of fuel oil or the feasibility of replacing aging generation. He reported the RCA has been working on bulk fuel and with ATA. He reported that Representative Edgmon introduced a bill to amend the Power Cost Equalization (PCE) program. The RCA has reviewed the proposed legislation and provided analysis that the bill does not have any fiscal impact to the agency. He indicated the RCA plans to send staff to provide onsite training to help communities get reinstated in the PCE program. He hoped to accomplish training through grant funding by mid-year. He offered to report results back to the committee.

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MR. PATCH expressed his concern over four competing plans for LNG, for plants under consideration by Department of Natural Resources (DNR) or on the North Slope.

MR. PATCH referred to a large windstorm in Joplin, Missouri and other catastrophes. He expressed concern about power outages and his desire to provide more reliable electric utility systems as it relates to power outages. He said he hopes the RCA can address this issue.

MR. PATCH related the RCA has been involved in outreach with and the Department of Natural Resources (DNR), the DNR's State Pipeline Coordinator's Office, the Department of Environmental Conservation (DEC), and the Alaska Oil and Gas Conservation Commission (AOGCC) on matters such as fracking.

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CHAIR OLSON asked whether the Trans-Alaska Pipeline System balancing with Federal Energy Regulatory Commission (FERC) is completed.

MR. PATCH answered no. He reported the RCA received reply briefs from the eleven parties involved. He noted carriers were allowed up to 200 pages for reply briefs whereas other parties were limited to 150 pages. Thus, he estimated he has about 4,000 pages of briefing to read. He reported the RCA spent about 20 weeks of active preparation and in-hearing room time in Washington D.C. and Alaska. He detailed that 3,000 multi-page

exhibits exceeding 15 pages, with over 600 filing entries into 12 dockets spanning from 2008 to 2012, with over 12,000 pages of transcripts taken during the hearings and an estimated \$1 billion at issue. He related carriers have not elected to consider issues related to Pump Station 1 of the Trans-Alaska Pipeline System. He indicated he would be discussing the case with the chief judge for FERC while he is in Washington D.C.

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CHAIR OLSON asked for a summary of the aforementioned issue, which he would share with the Legislative Budget and Audit Committee (LB&A).

MR. PATCH offered to do so.

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REPRESENTATIVE SADDLER asked whether Mr. Patch needs any other resources or assets needed.

MR. PATCH answered yes. The legislature was most generous in funding additional engineering and financial analysts. He clarified the importance of RCA's staff to understand emerging issues and the best practices process to assist in forward thinking. While the positions were authorized, the RCA needs additional space for staff, he said. He hoped to discuss space concerns with Commissioner Hultberg yet is well aware of the governor's desire to hold costs and not expand the budget. He suggested the RCA has an authorized budget and funds itself from ratepayers so this would not be a drain on state resources.

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CHAIR OLSON remarked that the RCA complied with all matters related to the last sunset audit. He said he did not think extending the RCA for an additional eight years was unreasonable in terms of the sunset extension.

MR. PATCH concluded the RCA did not ask for relief from timeline issues. He reported the RCA has not missed a single shortened deadline. To summarize, the RCA has kept its promise to the legislature, the RCA has been efficient, and the utilities have appreciated his efforts. He characterized the utilities' feedback as being a positive motivation for him.

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ADJOURNMENT

There being no further business before the committee, the House Labor and Commerce Standing Committee meeting was adjourned at 4:59 p.m.