

SENATE FINANCE COMMITTEE  
FAIRBANKS LEGISLATIVE INFORMATION OFFICE  
November 1, 2013  
9:00 a.m.

Note: The following meeting convened in the Fairbanks Legislative Information Office and was teleconferenced and recorded in Juneau.

[9:00:24 AM](#)

CALL TO ORDER

Co-Chair Kelly called the Senate Finance Committee meeting to order at 9:00 a.m.

MEMBERS PRESENT

Senator Pete Kelly, Co-Chair  
Senator Kevin Meyer, Co-Chair  
Senator Anna Fairclough, Vice-Chair  
Senator Click Bishop  
Senator Mike Dunleavy  
Senator Lyman Hoffman

PRESENT VIA TELECONFERENCE

Senator Donny Olson; Fred Sturman, Self, Kenai.

MEMBERS ABSENT

None

ALSO PRESENT

Kristin Erchinger, Member, Alaska Retirement Management Board; Robert Grove, Retired Public Employees of Alaska; Ron Johnson, Retired Public Employees of Alaska; Charles Gallagher, Chair, Retired Public Employees of Alaska; Michael Barnhill, Deputy Commissioner, Department of Administration; Angela Rodell, Acting Commissioner, Department of Revenue; Gary Bader, Chief Investment Officer, Treasury Division, Department of Revenue; David Teal, Director, Legislative Finance Division; James Armstrong, Staff, Senator Co-Chair Meyer; William Streur, Commissioner, Department of Health and Social Services; Senator Charlie Huggins.

SUMMARY

Unfunded Liability for Public Employees' Retirement System (PERS) and Teachers' Retirement System (TRS) Presentations:

Alaska Retirement Management Board  
Department of Administration  
Legislative Finance Division  
Department of Revenue

FY 14 Budget Overview and FY 15 Budget Preview:

Department of Health and Social Services

[9:00:39 AM](#)

^PRESENTATIONS: UNFUNDED LIABILITY FOR PUBLIC EMPLOYEES' RETIREMENT SYSTEM (PERS) AND TEACHERS' RETIREMENT SYSTEM (TRS)

[9:00:52 AM](#)

KRISTIN ERCHINGER, MEMBER, ALASKA RETIREMENT MANAGEMENT BOARD, testified that the board had researched and educated itself about the issue of unfunded liability. The board wished to convey the information to the legislature for decision making purposes. She initiated the PowerPoint presentation titled "Alaska Retirement Management Board" dated November 1, 2013 (copy on file). She noted that some slides would be skipped in the morning, but the presentation was available in member's packets and on BASIS for the public.

Ms. Erchinger began with slide 1: "Alaska Retirement Management Board (ARMB)."

- Role of the Alaska Retirement Management Board
- ARMB Actions(and Limitations) to Address Unfunded Liability
- Funding Request
- Outcomes of Anchorage Stakeholder Workshop

Ms. Erchinger recognized that the unfunded liability of the retirement system was astronomical with a significant effect on the state. The actions taken by ARMB on the unfunded liability strained the state budget making it

difficult for competing stakeholders. Stakeholders were poled at a recent meeting to attempt to craft a solution of least financial impact for Alaska.

[9:04:03 AM](#)

Ms. Erchinger continued with slide 2: "Role of ARMB."

- Alaska Retirement Management Board (2005 - present)
1. Manage/invest assets to meet liabilities and pension obligations of the systems, plan, program and trusts.
  2. Set employer contribution rates
  3. Greater duty w/respect to pension liabilities and obligations
  4. Recommend to budget-setting and appropriations arms of gov't, but cannot appropriate or submit a budget
  5. Adopt investment policies for each of the Funds; approve investment options for DC plans after consulting with Plan Administrator.

Ms. Erchinger continued with slide 3: "Role of ARMB."

6. Approve investment objectives for DB Plans
7. Annual actuarial evaluation to determine assets, accrued liabilities, funding ratios and certify appropriate contribution rate for normal cost and liquidating past service liability
8. Annually report to Governor, legislature, employers valuation of trust fund assets and liabilities and other statistical data to understand system
9. Quarterly report of investment performance to Legislative Budget and Audit
10. Contract for services to execute boards powers and duties

Ms. Erchinger discussed slide 5: "Limited Ability to Impact Unfunded Liability."

ARMB Responsibilities:

- Determine asset allocation and investment objectives
- Determine amortization methodology
- Set investment return assumption
- Set employer contribution rates
- Provide input on actuarial assumptions

[9:06:37 AM](#)

Ms. Erchinger noted that a typical pension system had 70 percent of paid-out benefits derived from investment earnings. To the extent that ARMB had sufficient assets in the retirement plan, future benefits would be paid, but without the money upfront, investment earnings would not provide the necessary benefit payments. The benefit payments would instead come from the state and employers in the system. She stressed the importance of up-front money available in the system to drive the earnings to pay pension benefits.

[9:08:42 AM](#)

Ms. Erchinger stated that the level percentage of pay method held that as the covered payroll grew, the mortgage payments grew over time. The board recognized that the plan was contrary to Alaska's likely reduction in oil revenues. A levelized mortgage payment would allow a closer match to the future state revenue.

Ms. Erchinger added that ARMB set the investment returns assumption and employer contribution rates.

[9:09:34 AM](#)

Ms. Erchinger noted that actuarial assumptions were often seen as untrustworthy and as the cause of the unfunded liability. She argued that other factors contributed to the state's unfunded liability. She discussed a change in plan benefits in recognition of the tremendous liability. She agreed that actuarial assumptions played a large role in the unfunded liability of the state's system, but she stressed that the assumptions provided the best tool for the board.

Ms. Erchinger noted that the board had been criticized for not doing enough to solve the unfunded liability problem. She explained that the board could not appropriate funds and submit budgets to affect the unfunded liability. She stated that the board supported pension obligation bonds as a tool, but she could not authorize issuance of bonds or any type of loan between state funds.

[9:11:34 AM](#)

Ms. Erchinger stressed that the board wished to open a dialog with the legislature. She noted the board's support of direct appropriations by requests through the legislature into the PERS and TRS system. She noted that the money would earn interest to pay pension benefits, reducing the need for future contributions from the state in the future. The board supported the use of the use of pension obligation bonds as a partial and potential solution to address the unfunded liability. She noted the reduction of the earnings assumption rate in the plan from 8.25 percent to 8 percent. She noted a change in the amortization payment to flatten the mortgage payments over time.

Slide 7: "Where We Have Been." The Alaska Retirement Management Board evaluated 40 potential scenarios in 2011.

Recommended:

- 25-year or 30-year amortization
- Lump-sum contributions with continued State assistance
- Change to level dollar amortization

Rejected:

- Lump-sum contributions with no further State assistance >22 percent
- Cost-shifting from the State to municipalities and vice-versa
- Requiring assets outside trust fund be used to set rates
- Extending amortization if significantly higher costs than status quo

Ms. Erchinger mentioned that in 2011, the ARMB reduced their earnings assumption from 8.25 percent to 8.00 percent. The return was believed to be consistent with the asset allocations. The risks and rewards of the allocation were balanced to achieve the target return. She noted increased difficulty achieving the target return with the oncoming liquidity problem. With insufficient assets to pay benefits, the state must draw down their assets affecting the ability for long-term investment. The decision to reduce the investment earnings assumption from 8.25 percent to 8.00 percent impacted the funded ratio because future assets will be lower as a result of the lower investment return.

9:13:53 AM

Ms. Erchinger moved to slide 8: "Impact of Reduced Earnings Assumption."

- Reduced earnings assumption 8.25 percent to 8.00 percent
- 3.12 inflation assumption = 4.88 percent real return
- Return is consistent with asset allocation
- Reduces funded ratio due to lower assumed future assets
- Increased ER rate by 1.53 percent PERS; 1.88 percent TRS (2012)

Ms. Erchinger highlighted the investment returns on slide 9. The slide intended to display the board's ability to meet the 8 percent return assumption. The returns were net of fees, resulting from the investment fees minus the the cost of running ARMB and the retirements system.

Senator Bishop asked how close the actuarial assumptions predicted the returns displayed in slide 9.

Ms. Erchinger replied that a later presentation would offer the requested information. She noted that in the 20-year term the assumption was just under the 8 percent return, while the 30-year was greater.

Co-Chair Meyer wondered about the asset allocation. He asked about the equity/bond ratio.

Ms. Erchinger responded that ARMB was highly invested in equities that were split between domestic and international. She mentioned that the board had lowered its allocation in recent months to fixed income with the anticipation of increasing interest rates. As interest rates rise, the values of fixed-income investments fall. The board strived to move out of fixed-income and into equities. She discussed the investment in infrastructure such as farmlands, timber and real estate providing long-lived assets with a higher return.

Co-Chair Meyer appreciated the information and was happy to see that the board was investing in a manner comparable to the Permanent Fund Board.

[9:17:00 AM](#)

Ms. Erchinger referenced slide 10: "Impact of change from Level Percent of Pay to Level Dollar Amortization."

- Reduces overall contributions by nearly \$2 Billion
- Reduces State Assistance by \$1.26 Billion
- Reduces overall State payments by \$1.64 Billion\*
- Reduces Muni payments by \$285 Million
- Level Percentage of Pay delays contributions to future
- Level Dollar results in higher contributions in early years, reduced contributions later
- Increased contributions rates for PERS by 7.21 percent of pay and for TRS by 13.07 percent of pay
- Since 2006, Level Dollar would have added \$6.23 Million addtl to PERS; \$351 Million addtl to TRS

\*Includes State Assistance and State payments as an employer

[9:19:10 AM](#)

Ms. Erchinger discussed slide 12: "Why change Level Percentage of Pay to Level Dollar." The graph's red line depicted the new method for state assistance payments. While the levels would increase in the short-term, the later years would see the reduction of the required state contribution. The blue glide path depicted the former amortization method, which over time increased the payments required by the state.

Ms. Erchinger continued discussing slide 12 and noted that the blue path projected state-assistance payments of 22.6 percent by FY 29 of general fund unrestricted revenue. The red line predicted a maximum percentage of 18.7 percent in FY 19. The general fund unrestricted revenues resulted from the historical number via the 2012 Fall Revenue Source Book.

[9:21:32 AM](#)

Ms. Erchinger stated that the forecasted revenues came from the spring 2013 Revenue Forecast adjusted by fiscal note for SB 21. The level dollar forecast assumed no additional oil production. Slide 13 depicted the same information in numeric format.

[9:22:02 AM](#)

Ms. Erchinger referred to slide 14: "Projected Actuarial Results Revised."

ARMB requested actuaries revise Table of Projected Actuarial Results purporting to show System overfunding (surplus) in excess of \$3 Billion by 2072, as misleading.\*

Ms. Erchinger discussed slide 15: "Where we have Been."

The Alaska Retirement Management Board evaluated 40 potential scenarios in 2011.

Recommended:

- 25-year or 30-year amortization
- Lump-sum contributions with continued State assistance
- Change to level dollar amortization

Rejected

- Lump-sum contributions with no further State assistance >22 percent
- Cost-shifting from State to municipalities and vice-versa
- Requiring assets outside trust fund be used to set rates
- Extending amortization if significantly higher costs than status quo

[9:25:14 AM](#)

Senator Hoffman asked if the \$28 billion was reflected in the chart.

Ms. Erchinger responded no. Slide 13 reflected the state assistance payment.

Ms. Erchinger explained that the most costly option included the elimination of state assistance. She furthered that the solution provided by the board was the least costly for the long run. Less expensive solutions require greater state contributions up-front. She related the issue to SB 187 and the added cost of approximately \$11 billion

in the legislation's proposed scenario. Since the board's plan would extinguish the entire debt by \$28 billion, the legislation proved too expensive for the state.

Senator Hoffman asked if the state would have been reimbursed all contributions under SB 187.

Ms. Erchinger replied that the lines highlighted in SB 187 that the status quo showed that the municipalities' cost would be \$3.6 billion today and would rise to \$10 billion under SB 187. The cost would shift from the state to the municipalities. With SB 187, state assistance payments would be eliminated.

[9:28:25 AM](#)

Ms. Erchinger offered to provide the committee with additional information from the actuaries to help the committee further research the issue. She suggested that the legislature guide ARMB regarding the level of state assistance payments that could be feasibly financed. She wanted to know the amount of payment that the legislature would be willing to make and how it would change over time. She also wished to know the level of up-front cash infusion possible. With the information, the board could begin running scenarios to meet the target.

Ms. Erchinger continued that the assumptions would change as a result of the legislature's input. She supposed that the amortization period might require an extension and different options could be considered. Without the key information, the target and solution are difficult to acquire.

[9:30:05 AM](#)

Ms. Erchinger discussed slide 23: "State Assistance: Baseline vs. \$2B injection." She noted that ARMB had submitted a request for funding to the legislature at the end of the legislative session for a \$2 billion injection into the system to be spread over 4 years. The outcome of the meeting with the stakeholders yielded the question about spreading the money out over 4 years. Slide 23 provided further information to the committee about the request.

Ms. Erchinger continued with slide 23. She noted that the red bar depicted the state assistance payments with the state contributing \$500 million per year for 4 years in a row. After 4 years, the red glide path reduced the required state assistance payments over time. When oil revenues were expected to be much lower, the impact on the state budget would be reduced by \$322 million per year on average. She stressed that any contribution today would limit the contributions required in the future.

Senator Hoffman asked if the interest rate assumed was 8 percent.

Ms. Erchinger concurred.

[9:32:29 AM](#)

Ms. Erchinger discussed slide 29: "Primary Outcomes."

- Borrow from ourselves
  - Mitigates risks of borrowing from capital markets
  - Provides guaranteed return to reserves
  - Prefer to borrow from CBR since SBR earnings are swept into GF
  - State's bond rating not adversely affected if we borrow from ourselves
  - Demonstrates that Alaska has a plan to address U/L
  - Leverages significant reserves without consuming them
- Direct appropriation
  - Prefer a single lump-sum rather than spread over multiple years
- Pension Obligation Bonds as a partial solution

Majority agreed on the need for substantial injection into system now.

[9:35:28 AM](#)

Vice-Chair Fairclough asked about other retirement systems managed by the ARMB. She noted that the state contributed to the other retirement systems. She requested a brief synopsis of the status of the systems.

Ms. Erchinger deferred the question to another board member.

Vice-Chair Fairclough wondered about the possibility of over-funding one of the pension programs.

[9:36:24 AM](#)

AT EASE

[9:38:52 AM](#)

RECONVENED

ROBERT GROVE, RETIRED PUBLIC EMPLOYEES OF ALASKA, thanked the committee for addressing the issues. He noted much confusion among current and potential retirees throughout the state regarding the unfunded liability. He also thanked ARMB and the information provided by the board. He recalled his previous position with Alaska Housing Finance Corporation (AHFC). He believed that the problem with Alaska's retirement system was repairable and he suggested a comparison of Alaska with other states in the nation. He stated that Alaska had options to solve the problem unlike other states who delayed action on similar issues.

[9:41:34 AM](#)

RON JOHNSON, RETIRED PUBLIC EMPLOYEES OF ALASKA, thanked the committee for their attention to the issue. He echoed the opinion of ARMB regarding the transition to the level dollar or up-front cash infusion. He worried about the future retirees and their solvency. He preferred not to see a vote to access the Permanent Fund to bail out the retirement fund. He preferred a use of budget reserves to reduce the total payments over time. He commented about the earnings assumptions. He mentioned that the public pension funds saw good returns in the last 10 years. He supported the idea of a cash infusion or level dollar to the current pay-down.

[9:44:53 AM](#)

CHARLES GALLAGHER, CHAIR, RETIRED PUBLIC EMPLOYEES OF ALASKA, stated that Alaska had progressed with the work on this very important issue. He expressed gratitude that ARMB and the legislature were addressing the situation. He agreed with the testimony provided by ARMB. He stated that multiple meetings occurred in Fairbanks over the summer to address the unfunded liability problem.

9:47:05 AM

AT EASE

9:48:12 AM

RECONVENED

MICHAEL BARNHILL, DEPUTY COMMISSIONER, DEPARTMENT OF ADMINISTRATION, provided a PowerPoint presentation titled "Public Employee Retirement System (PERS) Teachers Retirement System (TRS) Fall 2013 Update (copy on file)." He noted the intention of the slides to produce both introductory information as well as an update.

Mr. Barnhill stated that the governor believed that the unfunded liability presented a very serious problem to the state.

9:50:07 AM

Mr. Barnhill communicated that the administration believed in the moral obligation to ensure that all benefits were paid when due. He stressed the importance of the long-term nature of the commitments necessary and the need to ensure that the commitments were kept through 2070 or 2080. He offered gratitude to the legislature and the assistance provided on behalf of school districts and municipalities.

9:51:45 AM

Mr. Barnhill added that Alaska had a unique situation regarding state funding of school district retirement systems. He added that approximately 159 municipalities participated in PERS. He noted that the state legislature had appropriated \$609 million since 2008 to the state's retirement systems. He stated that municipalities must also pay their obligations in a timely fashion.

9:52:14 AM

Mr. Barnhill stated that the administration agreed to consider the lump-sum solution presented by Ms. Erchinger.

Mr. Barnhill discussed slide 2: "PERS/TRS Basic Facts Organization." He explained that three entities had key roles in the function of the state's pension system. He began with Department of Revenue and the Division of Treasury, which was charged with acting as staff to ARMB

and managing the trust funds for each of the state's pension systems. The division managed a great variety of assets. The fiduciary of the assets was ARMB. The board was created in 2005 during the closure of the Alaska defined benefit system to new entrants in FY 07 and the closure of the previous boards.

Mr. Barnhill explained that his department, the Department of Administration (DOA) was statutorily charged with administering the liability side of the state's equation. He elaborated that DOA calculated and issued the pension checks, processed retirement health claims, worked with actuaries on various projections to help with the administration of the system. He noted that many pension systems had a different organization. He referred to California and their state's retirement system organization.

[9:55:10 AM](#)

Mr. Barnhill discussed slide 3: "PERS/TRS Basic Facts Membership" and the active employees. He highlighted the 36,300 active employees in PERS. Since the closure of the defined benefit system in 2006, the number of people in the defined contribution system had risen steadily. He added that approximately 40 percent of the payroll was now active in the defined contribution system. He added that the increase was less pronounced in TRS with 35 percent of active teachers in the defined contribution system. He noted that the state had approximately 41,000 retirees with anticipation of numbers greater than 60,000 in the next 20 years.

[9:56:59 AM](#)

Mr. Barnhill discussed slide 4: "PERS/TRS Basic Facts Defined Benefits."

Defined Benefit Pension: fixed benefit amount from date of retirement to death.

Contributions + Investment Earnings = Benefits + Expenses

If All actuarial assumptions are accurate

Actuarial Assumptions:

Inflation, Investment Return, Mortality, Date of Retirement, Cost of Healthcare, Payroll Growth, Disability, Spouse Age, Dependent Children, COLA, Plan Expenses, Turnover

Inaccurate Projections lead to Unfunded Liability

Employer Takes the Risk

[10:00:29 AM](#)

Mr. Barnhill stated that multiple actuaries were hired by the state to make a series of actuarial assumptions.

Mr. Barnhill discussed slide 5: "PERS/TRS Basic Facts Contributions - Employee." Contributions were derived from two different populations, the employees and employers. The employee contributions for PERS and TRS were set in statute. He stated that police and fire employees paid 7.5 percent from their paychecks every payroll period. The other employees in PERS paid 6.75 percent and TRS employee contribution rate was 8.65 percent for the teachers retirement trust. He explained that the amounts were fixed in Alaska because of a section of the state's constitution known as the diminishment clause, which prohibits changing features of the defined benefit system once an employee is hired. The Supreme Court maintained that benefits vest on the date of hire.

[10:03:08 AM](#)

Mr. Barnhill discussed slide 6: "PERS/TRS Basic Facts Contributions - Employer." He repeated that if the actuarial assumptions fell short, the employer must make up the difference through employer contribution rates. He stated that the red line depicted the TRS contribution rate, while the blue line represented PERS contribution rate. He pointed out that rates had grown substantially since 2005. The ARMB developed a defined contribution rate of 40 percent for the employer in PERS and 66 percent for TRS.

Mr. Barnhill stated that the rate increase was due to the inaccuracy of the actuarial assumptions. He noted that actuarial assumptions set in the 1990s were too low. Health care cost growth was increasing in the late 1990s

contributing and were not reflected in the actuarial calculations. The board brought a suit against its former actuary Mercer for actuarial negligence, which was settled for a sum of approximately \$500 million.

[10:05:56 AM](#)

Mr. Barnhill recalled the 1999-2001 time period of economic recession brought on by the dotcom collapse in the equity market. Subsequently, other investment losses in the 2009 time period were weathered. The 8.25 percent rate of return was an investment assumption that had not been realized and contributed to the increases in employer contribution rates.

Mr. Barnhill referred again to slide 6 and the green and purple lines. He noted that those lines depicted the result of relief from the high contribution rates through a bill, SB 125 enacted in 2008. The bill capped the rates paid by the employers for TRS at 12.56 percent for PERS at 22.00 percent of payroll.

[10:08:32 AM](#)

Mr. Barnhill noted that the results of the capped employer contribution rates included state assistance for approximately \$1.7 billion.

Mr. Barnhill continued with slide 7: "PERS/TRS Basic Facts Investment Returns." He noted that the past investment return assumption adopted by the Alaska State Pension Investment Board and subsequently by ARMB was 8.25 percent and recently reduced to 8.00 percent. The slide depicted the annualized return scenarios for both PERS and TRS over various time frames. He pointed out that last year was a great period with earnings of 12.5 percent. The prior years were less successful. He remarked that the returns listed on the slide were gross returns and did not include the expenses.

[10:11:59 AM](#)

Mr. Barnhill detailed slide 8: "PERS/TRS Basic Facts Benefits."

DB Benefit Amount:

Sum of multipliers X Avg. High 3(Tier 1-2) or Avg. High 5 (Tier 3)

PERS Multipliers: 2 percent first 10 yrs; 2.25 percent second 10 years; 2.5 percent thereafter

TRS Multipliers: 2 percent first 10 years; 2.5 percent thereafter

Example: 30 years PERS service:

$(2\text{percent} \times 10) + (2.25 \text{ percent} \times 10) + (2.5 \text{ percent} \times 10) \times \$85,000 =$   
 $67.5 \text{ percent} \times \$85,000 = \$57,375$

Note: State of Alaska employees also participate in the supplemental annuity plan (SBS).

Co-Chair Kelly clarified that the 25-year look provided the current assumptions.

Mr. Barnhill concurred. He noted that the topic encountered much debate. Some economists believe that a defined benefit public employee system should not adopt an interest rate assumption above a riskless rate of return. He added that the majority of pension systems adopted a rate of approximately 8.00 percent. He stated that the adoption of a lesser rate (4.50 percent) would double the current unfunded liability.

[10:15:19 AM](#)

Mr. Barnhill stated that the majority of the actuarial community agreed that 8 percent was the appropriate rate of return.

Vice-Chair Fairclough asked about the effect of the rate of return on Alaska in the form of liquidity.

Mr. Barnhill deferred issues involving liquidity to Mr. Bader. He pointed out that liquidity was an issue for Alaska as a closed system.

Mr. Barnhill discussed slide 9: "PERS/TRS Basic Facts Benefits." He noted that the chart displayed the total benefit payouts between 2013 and 2080. In 2013, the state would pay \$1.5 billion in pension and healthcare benefits between PERS and TRS. As the number of retirees grows, the

amount of benefits would exceed \$3.5 billion annually in approximately 2036. The total spending on the system between 2013 and its closure would be \$140 billion over the next 70 years. He assured that with actuarially required payments and good assumptions, the trust funds would have sufficient funds to pay the necessary benefits. He admitted that future time periods might yield down-turn investment markets allowing for new unfunded liabilities.

[10:19:38 AM](#)

Mr. Barnhill noted discussion about the development of a new defined benefit plan. Until the fiscal structure of the state was stable enough to support a defined benefit plan, the department opposed the creation of a new defined benefit plan.

Mr. Barnhill discussed slide 10: "PERS/TRS Basic Facts Expenses." He noted that the one-year snapshot indicated that expenses added up to approximately 30 basis points. He stated that 0.3 percent of the return was deducted for expenses, which added up to \$54 million.

[10:20:57 AM](#)

Mr. Barnhill detailed slide 11: "PERS/TRS Events that Led to C+I=B+E."

- 2002 - Milliman actuarial audit; dotcom collapse
- 2003 - FY 02 valuations released with revised assumptions. \$4.1B unfunded liability
- 2005 - SB 141 enacted: Mr. Boyle plans closed; DC plans created; PERB/TRB/ASPIB sunset; ARM Board created
- 2007 - ARM Board files suit against Mercer for actuarial negligence; SB 123 enacted: PRS cost share

Senator Dunleavy asked about the comment that a return to a defined benefit system was unsustainable. He asked if a return was unsustainable under any scenario.

Mr. Barnhill responded no. He stated a return to a defined benefit system was sustainable if the state had a stable fiscal structure that could support sufficient revenues into the indefinite future.

[10:23:46 AM](#)

Mr. Barnhill continued with slide 11.

2008 - SB 125 enacted: employer contribution rates capped; state assistance begins; Great Recession begins  
2009 - PERS/TRS investment loss: (20.5%)  
2010 - Mercer litigation settled for \$500 mm (net \$403mm); other states begin to cut Mr. Boyle benefits, change plans;  
2012 - ARMB adopts level dollar amortization; \$11.9B unfunded liability  
2013 - 12.5 percent investment gain; recession over?

[10:26:24 AM](#)

Mr. Barnhill discussed slide 12: "PERS/TRS Funding Ratio History - PERS." The slide displayed the funded level, which was a percentage of assets to accrued liabilities. With 100 percent the state would have sufficient assets to pay accrued liabilities. The PRS system was 61 percent and the TRS system was in the lower 50 percent. He noted that actuaries claimed that 80 percent funded level indicated relative health in the system.

[10:27:25 AM](#)

Mr. Barnhill discussed slide 13: "PERS/TRS Funding Ratio History - TRS." The slide showed the monthly premiums charged to early retirees that pay for health insurance, which had increased by a compound rate of 9 percent annually since the late 1970s. He explained that the extraordinary increases in health care costs were not envisioned during the system's inception. He stated that monthly premiums were \$57 in the 1970s, and they have grown to over \$1200. The rate of growth flattened in the last few years. Predictions are for further increases in health care costs resulting from the Affordable Care Act.

[10:28:45 AM](#)

Senator Hoffman understood that other states had found modifications that allowed for more affordable plans. He asked if Mr. Barnhill would comment on the state's efforts to seek out more affordable options.

Mr. Barnhill replied that the state's retiree health plan remained static over the last 14 years, resulting from the diminishment clause. He mentioned changes made in the year 2000 time period. The changes resulted in litigation between the state and an advocacy group. The Alaska Supreme Court held that the retiree health care benefits were subject to the diminishment clause. The retirement healthcare benefits could be changed if one piece of coverage was eliminated or reduced.

[10:30:50 AM](#)

Mr. Barnhill pointed out that the decision led to unfavorable results for both the state and the retirees. He mentioned that retirees were competing for enhancements of benefits in the form of preventative care, which was not provided by the retiree plan. Another cause of concern was the lack of coverage for dependents to age 26, which was a function of the Affordable Care Act. The retiree health plan was not subject to the Affordable Care Act, the enhancement was not added.

Mr. Barnhill continued that the diminishment clause acted to freeze the retiree health plan. The state had strategies to improve the coverage and its sustainability from a cost perspective. The department planned to work with the retiree community through the fall and into the following year.

Co-Chair Kelly asked if employees contribute to the premium.

Mr. Barnhill responded that a fully vested retiree would pay nothing.

[10:32:16 AM](#)

Mr. Barnhill pointed out that the Affordable Care Act assumed that everyone should contribute a portion toward the premium of the retiree insurance plan. He noted that most people would pay 9.5 percent of modified adjusted gross income. Alaska's system allowed vested retirees to pay nothing. He explained that the defined contribution plan was different with the premium share provision. Depending on the years worked, a person would pay different levels of their premium.

10:33:09 AM

Vice-chair Fairclough asked about the Government Accounting Standards Board GASB (number 67 and 68) statements that would take effect. She understood that the reasons that health benefits were not separated with the reflection of the unfunded liability resulted from the diminishment clause as interpreted by the Alaska Supreme Court.

Mr. Barnhill said that the unfunded liability associated with healthcare was evaluated separately. Of the \$11.9 billion of unfunded liability, \$3.5 billion related to healthcare. He mentioned that GASB 67 and 68 presented new requirements imposed on public pension systems. The bills required computation of a new figure called the net pension liability utilizing a different and standardized formula. The primary difference was a standard method of computing the value of assets using a fair rather than actuarial value.

10:35:07 AM

Mr. Barnhill continued that the net pension liability was reported on employers' balance sheets beginning in FY 15. With PERS and TRS, the department would allocate the net pension liability for various participants in the system.

Co-Chair Meyer understood that other states did not include healthcare costs as part of their unfunded liability.

Mr. Barnhill replied that the medical piece was not part of GASB 67 and 68. Sometimes the medical piece referred to other post-employment benefits, which included health and life insurance benefits.

Co-Chair Meyer asked if a comparison of Alaska's unfunded liability to other states provided a fair comparison.

Mr. Barnhill replied that Alaska behaved differently than other states. For Alaska, the unfunded liability includes all school districts, municipalities and the state. He pointed out that California's unfunded liability did not include any school districts. Alaska reported a comprehensive unfunded liability. He noted that some states were beginning to report medical unfunded liability. He stated that most systems were computing the liabilities, but were not prefunding them. He noted that Alaska was

distinguished from other state entities with its practice of prefunding healthcare benefits since the 1970s.

[10:38:22 AM](#)

Co-Chair Meyer asked about the states bond ratings and the incorporation of medical costs.

Mr. Barnhill could not speak to the issue; he deferred the question to Commissioner Rodell.

Senator Hoffman asked if retirees had to pay monthly health care premiums for defined benefits in all tiers.

[10:39:35 AM](#)

Mr. Barnhill said he would get back to the committee with an answer.

Mr. Barnhill continued with slide 15, "Balance Sheet." The slide depicted the systems in terms of the actuarial value of assets and accrued liabilities. He noted the 61 percent funded ratio for PRS, 52 percent for TRS adding up to \$16.7 billion in assets and \$28.6 billion in accrued liabilities. The unfunded liability was listed at \$11.9 billion. He noted that the most recent treasury report showed assets of \$19 billion as of September 30, 2013.

[10:40:31 AM](#)

Mr. Barnhill stated that the next two charts, slides 16 and 17, illustrated approaches to unfunded liability and general fund appropriations. He noted that both methodologies depicted past state assistance under SB 125. He explained that both the level dollar and the level percentage of pay were displayed in the slides. He clarified that level percentage of pay was a "back-loaded" methodology, where level dollar was a "front-loaded" methodology that dropped over time. He reminded that ARMB recently adopted the level dollar methodology. The amount of money appropriated from the general fund to provide assistance would increase by approximately \$272 million in FY 15.

Mr. Barnhill furthered that both methodologies were acceptable from an actuarial point of view. Both methodologies ensured that all payments were made to

beneficiaries when due. He mentioned strategies used to address unfunded liabilities. The various strategies stemmed from the actuarial formula of contributions plus investment equals benefits plus expenses. He noted that the majority of solutions focused on contributions. A direct correlation could be found between the length of the term and the amount of the payments.

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Vice-chair Fairclough asked about liquidity.

Mr. Barnhill explained that a debt financing structure required payment sooner or later. Debt servicing costs would increase in aggregate over time. He noted the liquidity of the trust funds to pay benefits and liquidity of the general fund to meet requests presented to the legislature. He pointed out the challenge of structuring an approach that meets the requirements of paying benefits as well as cash flow needs. Additional approaches included payment into the reserve account and cash infusion.

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Senator Hoffman understood that administration acknowledged the unfunded liability as critical. He asked how the administration viewed cash infusion.

Mr. Barnhill replied that ARMB had a stakeholder meeting in August where Karen Rehfeld, Director, Office of Management and Budget, Office of the Governor indicated that the administration was willing to consider the approach of cash infusion.

Senator Hoffman asked about a time frame for commitment from the administration regarding cash infusion.

Mr. Barnhill stated that he could not commit to a time frame. He added that the adjustment of contribution rates was typically a function of altering the amortization method. He stated that some states had changed employee contribution rates, but he thought it unlikely in Alaska because of the diminishment clause.

Mr. Barnhill discussed investment returns. He pointed out that investment returns could not be manipulated to adjust the unfunded liability. He stated that ARMB had an asset

allocation heavily weighted to equities that was adjusted on an annual basis.

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Mr. Barnhill mentioned that the department addressed the benefit side of the equation by researching the reduction of health care costs without reducing health care benefits. He stressed that the benefits were secured by the diminishment clause. A new third-party administrator, AETNA was procured to replace the Health Smart. He noted that the new administrator had an advantageous discount provider network, particularly in the Lower 48. The department anticipated a cost savings of tens of millions of dollars annually.

Mr. Barnhill pointed out that auditing would enable further reduction of costs. He added that the diminishment clause prevented further adjustment to the cost of the benefits. He assured that both the Department of Revenue and the Department of Administration were striving to administer the system for optimal cost savings.

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Senator Hoffman understood that 40 percent of Alaskan retirees lived in the Lower 48. He wondered how that number had changed over the last decade.

Mr. Barnhill replied that he did not have the ten year look-back.

Vice-chair Fairclough asked the percentage rate of the cost of living adjustment affected.

Mr. Barnhill replied "some percentage of CPI."

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AT EASE

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RECONVENED

ANGELA RODELL, ACTING COMMISSIONER, DEPARTMENT OF REVENUE, provided an opening statement:

Thank you for the opportunity to make a presentation today. We have heard a lot about whether or not the pension trust funds are "healthy" or whether or not they are in "fiscal stress". We have also talked a lot about affordability. What can the state afford and what are our options going forward? Do we really need to do anything at this time? The State of Alaska was upgraded by Fitch and Standard & Poor's over the last two years and we now share triple A ratings from all three nationally recognized rating services. One of the primary reasons cited by all three rating agencies was good or sound financial management. Good credit scores for any of us means we sometimes have to make hard decisions. The legislature and the governors over the years have taken necessary and - at times uncomfortable - steps towards keeping the state on sound financial footing. It is no secret that we have a volatile revenue source which has led us to be conservative in our budgeting practices. We believe in paying up front for those things we are required to provide - even going so far as to forward fund education. We honor our debts, pay them off early if we can and equally importantly we honor our contracts.

The unfunded pension liability or net pension liability is the gap between the assets we have to fund the benefits promised under contracts made years ago. In 2005 the legislature and the governor took the very hard step of closing the defined benefit program so that the state could take direct control of its contract obligations by no longer promising benefits it may not be able to deliver. The liability continued to grow over those years because the costs of benefits grew more than predicted and expected investment earnings failed to materialize.

It is true that under any level percent of pay or level dollar amortization, liabilities will be paid off. So why should we take any other actions than those already described? Because this state needs to have the financial flexibility in future years to continue to grow this state - whether it is investing in a hydroelectric project, rebuilding coal fired facilities or making a major investment in a gas line from the North Slope. Right now we rely on the assets in the pension trust funds to generate enough cash to pay each year's benefits. We have designed an asset

allocation with the goal of earning at least 8%. If those assets do not generate enough cash to pay all the benefits, we are required to sell assets to come up with the cash deficiency. The unfunded liability will grow because we are unable to achieve 8% and requests to the general fund will be even higher than today. There are very real and tangible benefits to the State for addressing this issue now - the most important one maintaining financial resources to fund future priorities.

At this time I would like to turn to Gary Bader and have him walk you through an analysis we have prepared which will demonstrate in more detail our concerns about our future flexibility.

GARY BADER, CHIEF INVESTMENT OFFICER, TREASURY DIVISION, DEPARTMENT OF REVENUE, explained that the treasury division oversaw approximately \$50 billion of state assets. He stated that approximately \$22 billion of those state assets were for ARMB, with \$18 billion of the \$22 billion for the defined benefit plans.

Mr. Bader began the presentation, "Retirement Systems Liquidity Analysis":

#### Fund Liquidity Analysis

- Although there is a substantial unfunded liability in both PERS and TRS, there are billions of dollars to pay benefits well into the future.
- Benefits payments will increase substantially in the next decade. Unless addressed, the combination of increased benefit payments and insufficient assets in the trusts will require investing in more liquid assets.
- Investing in more liquid assets will negatively impact the rate of return of fund assets, therefore increasing the unfunded liability.

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Mr. Bader explained that his presentation's data was based on the actuarial report prepared by Buck Consultants and the valuation study as of June 30, 2012.

Mr. Bader addressed slide 3: "PERS Data Points, Fiscal Year Ending 2014 (Projection from Actuary)." He emphasized that the earnings assumption was 8 percent. The unfunded liability would increase substantially if ARMB were to lower its earning assumption. The ultimate purpose of a retirement system was to pay benefits. He noted that his references to liquidity were specifically directed to the methods of cash generation to pay benefits.

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Mr. Bader addressed slide 4: "PERS Data Points, Fiscal Year Ending 2014, Without State Assistance." The slide displayed the importance of the annual state assistance that the governor and legislature have appropriated to PERS. Without state assistance, the fund would require another half billion dollars of cash flow from investments to pay benefits. Investment returns were not cash. He estimated that the current investment program would generate approximately \$262 million for PERS this year. Without annual state assistance, the fund would have to sell some assets to pay benefits, which might impair the ability to earn the 8 percent return.

Mr. Bader referred to slide 5: "TRS Data Points, Fiscal Year Ending 2014 (Projection from Actuary)." He noted that the circumstances with TRS were similar to those of PERS with an 8 percent earnings assumption.

Mr. Bader addressed slide 6: "TRS Data Points, Fiscal Year Ending 2014, Without State Assistance." He noted that TRS required nearly as much as PERS to pay benefits without state assistance. For approximately \$4.8 billion of assets, TRS would yield approximately \$106 million, but the need is \$465 million.

Mr. Bader discussed slide 7: "Growth of Benefits, PERS/TRS." He noted that ARMB was addressing liquidity issues through the pooling of assets and opportunistically selling assets to rebalance funds. The slide demonstrated how the requirement to pay cash benefits would grow over the next nine years. Benefit costs for 2013 were \$1.5 billion with projections for 2022 of \$2.5 billion

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Mr. Bader detailed slide 8: "Annual Cash Yield Mr. Boyle Plans." He discussed methods for generating cash to pay benefits. He stated that fixed income was ordinarily the highest yielding asset class but with 10-year treasuries yielding approximately 2.5 percent, the state's fixed income return was "anemic." He stated that the state earned approximately 2.4 percent on the fixed income portfolio while the public equity portfolio yielded approximately 2.5 percent and real assets earned approximately 2.6 percent. He pointed out private equity with its unpredictable yield.

Mr. Bader discussed slide 9: "Ten Year Returns by Asset Class." The private equity asset class was the highest earning asset class, yet it could not provide a predictable cash flow for benefit payments. A change in the asset allocation to the private equity asset class would significantly impact the state's ability to earn an 8 percent return.

Mr. Bader detailed slide 10: "ARMB Liquidity Projection." He mentioned the state's pooling of assets as one of the strategies used to manage liquidity issues. Slide 10 detailed all of the funds managed by ARMB. He noted the department's daily management of the asset allocation of 14 separate funds. The funds were divided between the pension trusts for the separate benefit programs. He pointed out the slide's column headed "net contributions," which represented the cash in for all of the plans. By 2025, calculated with state assistance, the state will encounter a negative cash flow of \$1.2 billion. The liquidity problem will be quite serious by 2025 without sufficient assets in the fund and a strategy is not found to gain higher yield from investments.

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Mr. Bader said that when the legislature passed legislation related to the Permanent Fund Dividends, it required that dividends be paid out of realized earnings. The program was designed to avoid the sale of assets in order to pay the benefit or dividend.

Mr. Bader mentioned other strategies presented to the committee that described strategies to address the unfunded liability that were based upon an 8 percent earnings assumption. He noted the both the retirement systems and the permanent fund earned 7.3 percent. With 10-year

treasuries yielding approximately 2.5 percent, requiring a substantial portion of earnings to yield for dividends would create challenges for the system. He stated that the current return would make the challenge greater if assets must be sold.

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Vice-chair Fairclough asked if Mr. Bader suggested that the legislature implement a policy change for ARMB making it impossible for them to dip into the corpus of the retirement funds. She asked if Mr. Bader suggested that the legislature base a future fiscal plan on a rate of return.

Mr. Bader stated that he was not making the recommendation stated by Vice-Chair Fairclough. He stressed that without state assistance, the liquidity issue may drive events in a direction that is contrary to earning 8 percent. He believed that 8 percent was possible, and if the goal was not achieved, the contribution rate would be impacted, making it self-correcting. He simply wished to alert the legislature, the executive branch and ARMB to problems that may arise.

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Senator Bishop commented that the history of the stock market prior to 2008 yielded greater than 8 percent.

Commissioner Rodell agreed. She stated that a method of achieving the 8 percent return was to assess the driver of the return. The return was driven by the private equity. The private equity was not a liquid asset that could be easily sold. She noted that some assets required a great deal of time to sell and recoup the cash. She noted that the first indication of a negative difference would be seen in 2020 with a difference of \$38 million. The unwinding of an alternative investment must occur in 2020. With only five years to act, the state must determine the appropriate asset allocation. She pointed out that 2020 was an important year for mega-projects in the state.

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Vice-chair Fairclough asked about liquidity for payments.

Mr. Bader asked if Vice-Chair Fairclough was referring to general fund or retirement fund liquidity.

Vice-Chair Fairclough replied that she was referring to the retirement fund liquidity.

Mr. Bader explained that the retirement funds were addressing liquidity for payments and the 2.17 percent could be increased. He stated that he was studying the issue for ARMB to research a method to change the allocation for a higher yield without impairing the ability to earn 8 percent or more. He noted that endowments and foundations were required to yield 5 percent per year, but he acknowledged that they took more risks than the state was accustomed to taking.

Co-Chair Kelly asked about the quoted 2.7 percent.

Mr. Bader replied that 2.17 percent was the current yield.

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FRED STURMAN, SELF, KENAI, (via teleconference), stated that he had been concerned about PERS and TERS for some time now. He believed that outsourcing jobs was a possible solution. He suggested that privatizing the DMV was another possible solution. He thought that the change might lower the number of people counting on the system. He shared a personal experience with Social Security benefits.

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Vice-chair Fairclough asked about pension payments and privatization. She understood that when positions were eliminated, the state contribution continued. She queried the administration's position on the issue.

Mr. Barnhill responded that when a municipal employer eliminated a class department, the change would not necessarily trigger a termination study unless it included a class of positions or departments. He mentioned pending legislation, HB 152 that adjusted the conduction and triggering of termination studies. He stated the primary concern was to create a solution that did not shift costs from municipalities to the state. He pointed out that the state provided substantial amounts of relief to

municipalities. He suggested adjusting the cap of 22 percent.

Co-Chair Kelly introduced David Teal, Director, Legislative Finance Division and explained that he requested a personal opinion from Mr. Teal when soliciting the presentation.

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DAVID TEAL, DIRECTOR, LEGISLATIVE FINANCE DIVISION, believed that the retirement system would be an important topic of the next legislative session. He introduced the presentation, "A Discussion of Retirement System in Alaska" (copy on file). He stated that he was comfortable offering his personal opinion and would clarify the factual information in his presentation. He opined that the upcoming session would address the retirement systems and the Senate Finance Committee meeting provided an opportunity to inform legislators about the very important issue. He noted that an earlier meeting focused on background.

Mr. Teal posed the question on slide 2: "Are Alaska's Public Employee Retirement Systems Healthy?"

If not, what can be done about it?

Mr. Teal stated that the answer to the question was no. He planned to talk about actuarial concepts and policy guidelines with a focus on PERS.

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Mr. Teal discussed slide 2: "System Health refers to the likelihood that the promised benefits will be paid when due."

- Defined Contribution (DC) Plans
  - o No promised benefit level
  - o so not measure of health required
- Defined Benefits (Mr. Boyle) Plans
  - o Promised benefits (pensions)
  - o So it is critical to track and maintain system health

Mr. Teal moved to slide 4: "Measuring the Health of a Retirement System:"

1. Funding Ratio = Assets/Liabilities.
2. Unfunded Liability--just a dollar amount; not a relative measure.
3. Are employers paying the actuarially required contribution (ARC)?
4. Are the contributions causing financial stress?

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Mr. Teal stated that most retirement systems had funding ratios greater than 100 percent through the 1990s.

Mr. Teal discussed the graph on slide 5: "PERS Assets and Liabilities." The graph showed assets and liabilities in the funding ratio beginning in 2002. He stated that the assets and liabilities were closely matched for a number of years. He pointed out the gap occurring in 2005. He noted that the graph's dark line represented assets, the dotted line represented liabilities and the blue line represented the funding ratio. He did not have concern about the upward trend in liability because it was common for defined benefit systems. He stressed that investments must perform as expected for the system to function optimally.

Mr. Teal acknowledged that the systems were healthy for a long time, which begged the question about the system's current lack of health. He stated that unfunded liability was a consequence of assumptions that failed to materialize.

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Mr. Teal furthered that the defining attribute of a defined benefit plan was that the employer bears the risk of the system health. Unfunded liability was the consequence of risk becoming reality. He agreed with Mr. Barnhill that liability was a moving target. If any circumstance increased benefits to a greater than expected value, the funding ratio declined and unfunded liability appeared. He noted that the Mercer case was an example of utilizing outdated assumptions. With the adoption of better assumptions, the accrued liability increased.

Mr. Teal continued that when benefits followed assumption, assets sometimes failed to keep pace with the increase in benefits. He noted that approximately one-half of the \$2.5

billion liability in 2005 was attributable to the increase in liabilities and the decline of assets. He stated that retirement systems were designed to fill an unfunded liability gap over a 25-year period through small adjustments to the contribution rate. Actuaries calculate the expected benefits. Assets must increase by the same amount as the change in accrued liability.

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Mr. Teal turned to slide 8: "How Volatility of Investment Returns Affects Unfunded Liability." The excel sheet provided a simple model. The example used both liabilities and assets starting at \$12 billion, with an unfunded liability of zero.

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Mr. Teal manipulated the Excel spreadsheet as he testified in an effort to educate the committee about the system's variables, while exhibiting a variety of potentials outcomes.

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Mr. Teal made more Excel projections. He spoke to Slide 10:

1. Earnings are volatile and unpredictable.
2. Small variations can be addressed by smoothing, amortization and good fortune.
3. When variations are small, unfunded liability is a soft liability that can be repaid with earnings (rather than contributions).

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Vice-chair Fairclough asked if the state had realized the losses and sold something off to make up the difference.

Mr. Teal replied that the PFD did not pay out as much as the retirement system each year. The PFD paid dividends while the retirement system paid benefits. Although there was a recovery of assets, it had not been sufficient. He relayed that the assets were not a large but that the liabilities continued to grow. The permanent fund was viewed differently.

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Vice-chair Fairclough asked about 5-year averages if the system were closed out.

Mr. Teal stated that if the system had not been closed out the liability would have grown further. He pointed to slide 9 and noted that assets were not lost without recovery. The assets did recover, but liabilities were growing faster. The level analyzed was a ratio as opposed to a dollar amount.

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Mr. Teal resumed discussion of Slide 10:

4. The road to recovery from large losses can be very long—so long that the system may appear to be broken.
5. The system is unlikely to stay broken in the long-run.
6. If you pay what you owe, the system will fix itself.
7. As time passes, assumptions are replaced with reality.

Mr. Teal furthered that the third measure of system health was paying off debt. The system would fix itself if the debt was paid. Paying the debt exhibits to credit raters the willingness to pay other liabilities including bonds. The choice of assumptions allowed complex decisions regarding how much to pay toward liabilities.

Mr. Teal explained that Alaska was one of the only states to include healthcare costs in unfunded liability. The difference encouraged the perception that Alaska's system was less healthy.

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Mr. Teal opined that the state ought to concern itself with the problem of unfunded liability rather than compare itself to other states with similar issues.

Mr. Teal pointed to slide 12, "Arm Board Proposals."

- Cash infusion of \$1 billion to PERS and \$1 billion to TRS.

- Adopt the level dollar amortization method in order to accelerate contributions.

Mr. Teal elaborated that both proposals were aimed at improving system health. He noted that the cash infusion would immediately increase assets, which would reduce the unfunded liability and increase the funding ratio. He pointed out that the cash infusion proposal was similar to another rejected proposal two years ago. He noted that a change in the amortization method was more complex.

Mr. Teal mentioned a method of open amortization, which referred to a method that added any new unfunded liability to the existing unfunded liability and amortized it over 25 years. He compared open amortization to refinancing a home annually. He pointed out that with the open amortization method, the state would never pay off the unfunded liability. The gap would be constantly shifted into the future in hopes that future earnings would close the gap.

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Mr. Teal stated that soft liability referred to the ability of future earnings to fill the gap, as opposed to treating the liability like the death that it is. He pointed out that Illinois treated their unfunded liability as a soft liability. Illinois assumed that the contribution rate would remain the same, while future earnings filled the gap. He indicated that the solution was unsuccessful for Illinois. Fortunately, the proposal of open liability or amortization was not discussed in Alaska. Alaska used closed amortization with a fixed 25 year period. With the closed method, any unfunded liability created in a year would become a new debt with a new 25-year payment schedule.

Mr. Teal reviewed slide 13, "Amortization Methods":

- Level percent of pay amortization applies a constant contribution rate over the amortization period. Use of this method is near universal and is currently used in Alaska.
- Level dollar amortization splits unfunded liability into equal payments over the amortization period, much as for a standard home mortgage. Relative to the level percent method, payments to eliminate unfunded liability will be higher in the early years, and

contribution rates required to generate level dollar payments will decline over time. Because the level dollar method has larger payments in the early years, it is sometimes referred to as "front loading."

Mr. Teal added that both methods eliminated the unfunded liability at the end of the amortization period. Both methods were acceptable under GASB rules. He acknowledged that ARMB had debated changing level percent to level dollar with a final recommendation made for 2015. He opined that the recommendation was consistent with the ARMB philosophy that a funding ratio should be increased as rapidly as possible. Without the assets, there is no base to balance the system with earnings. The state could not survive on 8 percent earnings with low assets. Both methods achieved the same result, using different paths.

Mr. Teal discussed slide 14: "The ARMB Proposals: Questions to Consider."

1. Are the proposals necessary?
2. Does the path to full funding matter?
3. Are the proposals affordable?

Co-Chair Kelly [undecipherable].

Mr. Teal used a mortgage example in his response. He stated that level dollar compared to a standard mortgage. Level percent of pay was compared to an adjustable payment system, where payments would accomplish a percentage of pay. For the state, a constant level of payroll achieved lower payments in the early years, where the payments increased with payroll.

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Mr. Teal continued to answer the question. He stressed that no action was necessary. The state was on a path to full funding as determined by standard accepted actuarial methods. He saw no imperative to deviate from the current path.

Mr. Teal noted that the recovery from investment losses could stretch over long periods of time. The state's loss of greater than 20 percent in assets over 2008 and 2009 ensured that the path to recovery would be long. He argued that a move to level dollar was an overreaction. He asked

if the path mattered. He assumed that the path mattered to ARMB since the change to level dollar was proposed. The changes were recommended in the hope of large financial savings to the state.

Mr. Teal noted that ARMB did not discount future cash flows. The savings projected by ARMB were attributable to the earnings made on the higher balances. A cash infusion would allow higher earnings. Higher earnings allowed lower contributions, which would lower the need for state assistance. He pointed out that the higher balances available to the retirement systems were generated by the state. The state would forgo the earnings that they would have earned on the money without a cash infusion to the retirement system. A cash infusion would not provide a savings to the state.

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Mr. Teal referred to slide 15: "Annual State Assistance Savings from \$2 Billion Cash Injection (vs. Status Quo) (PERS Only). He stated that the information provided on the spreadsheet agreed with slide 25 of "Alaska Retirement Management Board" dated November 1, 2013 (copy on file) presented earlier by Ms. Erchinger. He noted that the cumulative savings over the baseline scenario with a cash infusion allowed the necessary savings assuming that today's dollar was comparable to one in the future. He argued that a decline in state contribution did not necessarily equal state savings. The state would most likely see earnings on the money if it was not used for the cash infusion.

Mr. Teal noted that applying a discount rate was a more typical method of addressing similar cash flows. If the state earned money on the balances, the cash infusion to the retirement system would cost the state more than allowing the money to continue earning in its current scenario. He suggested that if earnings were greater than 2 percent, the state might reconsider the cash infusion.

Senator Hoffman asked [undecipherable] 8 percent.

Mr. Teal replied that an 8 percent return was highly unlikely. He projected earnings of approximately 3-4 percent.

Co-Chair Kelly suggested a reserve account.

Mr. Teal replied that the question about a reserve account was debatable. He pointed out slide 16: "Measuring the Health of a Retirement System."

1. Funding Ratio = Assets/Liabilities.
2. Unfunded Liability --just a dollar amount; not a relative measure.
3. Are employers paying the actuarially required contribution (ARC)?
4. Are contributions causing financial stress?

Mr. Teal highlighted number four: "Are contributions causing financial stress?" He believed that the affordability of the chosen path was a crucial measure of system health. Former chairs of finance chose not to address the issue due to thinking that high contribution rates were best made when the state could afford them. Reductions of costs were best anticipated for times without budget surpluses. He stressed that the day of deficits had arrived for Alaska. He noted the timeliness of the committee meeting.

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Mr. Teal shared that he attended the recent National Conference of State Legislatures (NCSL) pension task force meeting and he was informed that he was not alone in believing that fiscal stress was an important measure of system health. The task force addressed the concern that the many figures available for detailing pension system data that might prove concerning to legislators and the public. Until 2013, the GASB rules were used for accounting, rating and for funding. He noted current calculations for books, bonds and budget. The separate calculations were more easily understood when viewed individually.

Mr. Teal acknowledged that accountants, raters and legislators used the data for different purposes. He noted the lack of significant change in the computation of unfunded liability. He noted that the amount of unfunded liability would be reported even when payments were timely. Every municipality would now be required to report its share of pension liability. The rating agencies used a common set of assumptions with the goal of comparability.

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Mr. Teal elaborated that rating agencies utilized a uniform set a rules, which was different from the state's unique amortization methods. By using a uniform set of assumptions, comparability was made available. The assumptions used were often more conservative than 8 percent. The numbers calculated by the rater would imply a less healthy system for Alaska. The numbers calculated by the raters with a number of downgrades for municipalities and the state were not intended for use in accounting or funding.

Mr. Teal opined that GASB rules were confusing, as they no longer offered guidance regarding funding. In the past, the rules informed about the computation of the Actuarially Required Contribution (ARC). An adequate funding level was no longer offered in the process; the state must merely provide a number on their financial statement. With the lack of funding guidance, the task force offered advice to legislatures to put guidelines in statute. Another recommendation was to provide a description of the computation of the annually required contribution level. The plan should be exhibited in statute while bringing the system to full funding.

Mr. Teal detailed slide 19: "Advice from a National Pension Funding Task Force."

- Put funding guidelines in statute; Describe computation of the ARC (Annual Required Contribution). Show the plan to bring the system to full funding.
- The numeric approach offers sound guidance, but the funding ratio and other actuarial measures are not the most important measure of system health. What really matters is what is affordable.

Mr. Teal stated that the current funding ratio was identical to that in the past few years, but the health of the system deteriorated substantially because the state treasury could no longer afford the current plan. He clarified that the statement was his opinion.

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Mr. Teal discussed the graph on slide 20: "Comparing Three Cost Drivers to Available Revenue (\$ millions)." He stated that the three drivers (K-12, Medicaid and Retirement Assistance) took 50 percent of the unrestricted general fund revenue. If the three drivers increase as projected by 2022, the percentage will be closer to 94 percent of the state's revenue stream leaving virtually no money for agency operations or capital budget.

Mr. Teal detailed slide 21: "What Other States have Done to Improve Retirement System Health."

1. Increase Assets
  - a. Increase employee contributions
2. Reduce Benefits
  - a. Raise the retirement age
  - b. Increase service requirements
  - c. Reduce post-retirement adjustments
  - d. Adopt hybrid plans

Mr. Teal believed that Alaska was not behind other states in its planning because it closed the defined benefit system at the first signs of distress. When the plan was closed to new entrants, a radical change was seen in the liability curve. He referenced the graph on slide 23: "PERS Accrued Liability."

Senator Dunleavy asked if a successful hybrid system might be developed.

Mr. Teal replied in the affirmative. He opined that the issue could be vetted this session. He understood the benefit of a pension to retirees versus a lump sum of cash. He believed that a hybrid system could greatly reduce the employer risk while increasing the comfort of retirees. He stated that he had not seen an effective hybrid plan derived in other states.

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Mr. Teal believed the downward curve displayed on slide 23 allowed the state to move away from the standard actuarial approaches in which assets chase the liability curve upward. He stated that the goal was to end up with no assets when benefits were completely paid.

Mr. Teal addressed the National Task Force recommendations on pension funding policies on slide 24:

1. Be based on actuarially determined contribution rates—and the calculation of rates should be in statute so the plan is clear to employees, retirees, administrators, boards, and legislators.
2. Collect a consistent percentage of payroll—use the Level Percent of Pay amortization method.
3. Be disciplined—to ensure that promised benefits can be paid (i.e., pay the ARC).
4. Maintain intergenerational equity (i.e., the cost of benefits should be paid by the generation of taxpayers that were served by the employees who earned those benefits).
5. Require clear reporting to show how and when plans will be fully funded and the progress toward that goal.

Mr. Teal compared Alaska's revenue stream to a person with a mortgage losing their job and getting another that paid 20 percent less than the first. He acknowledged that a person in that position would not be expected to increase their mortgage payment. He opined that the person would probably refinance their mortgage to lower the payments.

Mr. Teal opined that the level dollar method was fine if the discount rate was low and the payments were affordable. He opined that the method was not in common use, not recommended and he found it to be an odd response to the fiscal stress that the state was experiencing.

Mr. Teal elaborated further on intergenerational equity. He opined that intergenerational equity was impossible to achieve. He noted that ARMB rejected any plan that failed to pay the unfunded liability by the early 2030s. At that point, defined benefit employees would no longer be a significant portion of the workforce. He agreed with the payment of normal costs as they accrued. He defined normal costs as those that were expected for a person's retirement.

Mr. Teal stressed that unfunded liability was not a normal cost and could not be paid in a way that maintained intergenerational equity. He provided an example of a person retiring in 2004 when unfunded liability was zero. If the system lost money, unfunded liability was created and the contribution rates would rise. The next generation would have to pay for the cost attributable for the previous generation of employees.

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Mr. Teal pointed out that an employer took the risk of all losses in a defined benefit system and must pay the unfunded liability. He explained that unfunded liability would be paid off in the early 2030s according to Buck's Actuarial model on slide 25: "PERS Assets and Accrued Liability." The liability would be paid at that time because the existing unfunded liability would be fully amortized. The model never developed new unfunded liability because earnings remain consistent at 8 percent.

Mr. Teal begged the question, what would happen if the earnings were less than 8 percent. The answer was that new unfunded liability would open in unpredictable ways. Contributions would require increases to compensate. He suggested that contributions could and probably would continue after the last defined benefit employee retired unless earnings were outstanding.

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Mr. Teal concluded that the obsession with intergenerational equity could lead to overly restricted policy decisions. He opined that the concept of intergenerational equity did not apply to unfunded liability. Defined contribution plans more accurately displayed intergenerational equity.

Mr. Teal noted that ARMB had a policy denying the shifting of costs between the state and the municipalities. He argued that ARMB proposals did indeed shift those costs. Adopting level dollar amortization, which increased the contribution rate above 22 percent, the state will pay 100 percent of the amount above 22 percent. Rates for municipalities would remain the same.

Senator Dunleavy pointed out that Regional Educational Attendance Area (REAA) funding was 100 percent state money.

Mr. Teal replied in the affirmative. He relayed that anytime state contributions increased without non-state employer's contribution increases, the costs were shifted to the state. The state clearly paid more than the municipalities.

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Mr. Teal addressed slide 26: "What is the Goal and What Options Might Achieve it?"

Goal: a healthy system - meaning a system with a plan to eliminate unfunded liability in a reasonable time at an affordable cost.

Mr. Teal stated his opposition to sideboards that were ignored. He did not object to a cash infusion. He preferred to focus on the goal of a healthy system. He pointed out that reamortizing the state liability would reduce the state cost, but would not save money, similar to the refinancing of a home mortgage. He noted that a change of the assumptions used in the model would only create further number games. He stressed that reality mattered more than the model. If the model was not the best reflection of expectations, it was unreliable as a planning tool.

Mr. Teal suggested that elimination of health care costs from the unfunded liability calculations was another potential solution. He argued that since the costs were real, there was no point in basing policy decisions on the incomplete data. He wondered how the state could reduce state assistance payments while maintaining the employer contribution rate at 22 percent and paying off the unfunded liability in a reasonable time frame.

Mr. Teal referenced slide 27: "PERS Assets and Accrued Liability." He predicted that unfunded liability would vanish in the 2030s because past service contributions would vanish. He noted that there would be few defined benefit employees working and accumulating additional benefits. Without contributions, the asset curve also declined with earnings as the only source of asset growth. The accrued liability would also decline because retirees

would reach their life expectancy. When the earnings accelerate, the balance grows and the model is skewed.

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Mr. Teal stated that the only option to place assets at zero when liabilities fall to zero was to earn less. He could see the potential modeled in slide 27. He argued that the information raised concerns about the ability to meet the future needs of Alaskans and sustain spending, which proved that the state was experiencing financial stress.

Mr. Teal acknowledged that he did not trust a model that looked 60 years into the future. He stated that as contributions fell to zero, the liabilities would decline leading to liquidity issues. He advocated for the inclusion of the information (lower interest earnings) in the model. He opined that the state would not benefit from contributions falling to zero. Contributions were the risk-based costs and intergenerational equity was not an issue. He pointed out that a 1 percent contribution rate would generate \$100 million per year. The maintenance of a contribution rate would address the liquidity needs.

Mr. Teal advocated for focus on the near term. He wondered why the state would choose to build its assets so high rather than holding them at \$15 billion. If the goal was to have zero assets when the liability curve reached zero, the safest option was to hold rates at 22 percent to eliminate future state contribution rates.

Mr. Teal recalled his efforts in SB 187. He referenced slide 28: "Recommendation: Reconsider an Approach like that in SB 187."

- A cash infusion sufficient to maintain system health while capping employer contributions at 22 percent.
- No more state assistance - saving approximately \$500 million annually for 15 years.

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Mr. Teal clarified that a cash infusion system did not dictate capping employer contributions. He believed that a cash infusion should be accompanied by lower rates. The adoption of level dollar leads to the rate increase. Eliminating state assistance was not essential to the cash

infusion plan. He acknowledged that the issue of cash infusion led to many different details encompassing the comprehensive package of retirement funding.

Mr. Teal concluded that action on funding was not imperative. He opined that addressing the computation of the ARC in a plan in statute was the minimum need for the legislature regarding the retirement system. If the legislature, governor and ARMB agreed on an approach, success was likely. He stressed that paying less than the required ARC would be a mistake as would paying more than the state could afford.

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Co-Chair Kelly thanked Mr. Teal for the presentation. He stated that a similar presentation would be offered during session.

Vice-Chair Fairclough asked about the new GASB rules and the mandates for municipalities. She wondered if bond ratings would reflect poorly on Alaska.

Mr. Teal replied that he had spoken with the raters and was assured that the reserve situation in Alaska was well understood. Municipalities had been saved from literal bankruptcy by the state. The unfunded liability had no required payment time. The unfunded liability was a lump sum for future predictions. He stated that bond raters wished to see a plan, hence the task force recommendation that a plan be stated in statute.

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RECONVENED

^DEPARTMENT OF HEALTH AND SOCIAL SERVICES FY 14 BUDGET OVERVIEW AND FY 15 BUDGET PREVIEW

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Co-Chair Meyer discussed the schedule for the afternoon.

JAMES ARMSTRONG, STAFF, SENATOR CO-CHAIR MEYER, relayed that Senator Kelly and Senator Fred Dyson had sent a letter

to Commissioner William Streur regarding potential cost saving measures the Department of Health and Social Services (DHSS) was looking to implement related to public assistance and Medicaid programs. Committee members had received a copy of the commissioner's response dated August 13, 2013 (copy on file). He detailed that three other offices were working on a response letter, which should be finalized in the next 10 days or so. He relayed that the commissioner had provided Medicaid and public assistance backup, but given time limitations the meeting would only focus on the Medicaid components.

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WILLIAM STREUR, COMMISSIONER, DEPARTMENT OF HEALTH AND SOCIAL SERVICES, communicated his intention to provide a high level overview related to Medicaid. He discussed that there were many moving pieces related restrictions on the expired federal American Recovery and Reinvestment Act (ARRA) funding and to the federal Affordable Care Act (ACA).

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Commissioner Streur highlighted that controlling Medicaid spending in the state came down to four variables. The department was currently looking at \$21 million to \$22 million in cost savings resulting from implemented measures. He hoped to come close to doubling the figure in the upcoming year. He stated that \$45 million out of a \$1.6 billion budget was not large, but it was a way to begin detailing some of the department's functions. He was hopeful that DHSS could take aggressive actions to increase the amount substantially in the coming year. He intended to discuss future plans and cost control. He relayed that a significant portion of funding for the Affordable Care Act was rooted in fraud control.

Commissioner Streur communicated that Medicaid was a service for low income patients. He noted that occasionally he received calls about Medicare; he clarified that Medicare was a federal program for individuals over the age of 65. He provided a handout titled "Attachment 2 - Medicaid" (copy on file). He relayed that Alaska joined the Medicaid program in 1972 and any actions required federal approval. The department had been required to submit an initial state plan; any amendments were made to the initial

plan. He detailed that Medicaid programs were spread across various DHSS divisions including the Office of Children's Services, and the Divisions of Behavioral Health, Senior and Disability Services, Healthcare Services, and Public Assistance (responsible for authorizing and identifying eligible recipients). The Division of Juvenile Justice recipients would be moved under Medicaid in the near future. Juvenile justice residents were not currently eligible for Medicaid because the residency was considered incarceration. The state could use state general funds to pay for the residents at a Medicaid fee scale; currently it paid 95 percent of "street" rate. He noted that the change would bring substantial savings.

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Commissioner Streur relayed that pages 8 and 9 of the handout illustrated Medicaid spending from 1991 to 2012. He did not intend to cover the changes in depth due to time limitations. He noted that ARRA funding occurred from 2008 to 2012; spending had been variable. He pointed to Legislative Finance Division charts depicting department spending by division on page 11. He noted that the data shown was confusing given that Medicaid spending across the five divisions was shown; however, the spending was not shown for the individual divisions. He was working to show Medicaid's impact in each of the divisions as opposed to Medicaid on its own.

Commissioner Streur discussed four ways to control Medicaid spending on page 13:

- Controlling eligibility
- Controlling covered services
- Controlling what we pay for those services or products
- Controlling how much or how often recipients access those services by controlling utilization

Commissioner Streur addressed the first method of controlling Medicaid spending: controlling eligibility (pages 13 and 14). He discussed that a maintenance-of-effort requirement was placed on states when ARRA funding was provided. The requirement had been extended to 2014 for adults and 2019 for children [through ACA]. He communicated that largely the state was not able to control eligibility because much of the program was federally mandated (e.g.

the percentage of poverty level, people covered, and other). He elaborated that there had been an attempt in ACA to make Medicaid coverage for all individuals up to 138 percent of poverty level; currently individuals up to 100 percent of poverty level were covered in Alaska with the exception of certain groups. Pregnant women, children, and some families were covered up to a certain level; childless adults without a disability under the age of 65 were not covered. He explained that ACA would extend coverage to everyone under 138 percent of poverty level. He provided a cost savings measure example; currently pregnant women and breast and cervical cancer patients were covered up to 175 percent of poverty level. The state could reduce the coverage to 100 percent or 138 percent of poverty level and put the individuals in the ACA Health Benefit Exchange to purchase insurance on their own. He emphasized that the scenario was nothing more than an example and was not meant as a recommendation. The change would save \$22 million in general fund spending. He noted the importance of weighing the benefits and disadvantages of potential changes.

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Commissioner Streur stated that under ACA, Medicaid eligibility would be done using a Modified Adjusted Gross Income (MAGI). The shift removed some of the income "disregards" (items not considered as income) that were previously allowed and increased the eligibility level. The department expected to see some increase in the number of individuals eligible for Medicaid.

Commissioner Streur directed attention to the second method of controlling Medicaid spending: controlling covered services (page 14). He had gone back and forth on the method given that approximately half of the services paid for in Alaska were optional. He noted that page 14 included a list of mandatory and optional Medicaid services. He had the ability to reduce some of the optional services; however, he likened healthcare to a balloon that would bulge in other areas if pushed in somewhere else. For example, he wondered how the removal of prescription drug coverage would impact emergency room and physicians' office visits, and individuals with chronic or acute conditions. He discussed home health services and that waiver programs served over 2,500 individuals with conditions that made them eligible for nursing home level of care; the state would have to pay for a \$100,000 per

year nursing home bed if home health services could not be provided for a cost of \$25,000 to \$40,000 per year.

Commissioner Streur stated that when looking at optional benefits the state currently had it was difficult to take a look at what it did not want to do. Other optional services included dental coverage and patient transportation. He discussed the major impact that removing transportation coverage would have on Medicaid recipients given that the state transported many individuals for medical services, particularly from rural Alaska. He relayed that transportation costs would total \$80 million in the current year. He communicated that it was not feasible to cut transportation unless the state chose to make substantial investments in rural areas to increase the specialty level of care.

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Co-Chair Meyer asked for clarification on the cost of transportation in the current year. Commissioner Streur responded that transportation for Medicaid recipients would cost \$80 million in the current year. Co-Chair Meyer remarked that the number was significant. Commissioner Streur agreed.

Commissioner Streur relayed that going forward the department would look at ways to reduce transportation costs. The department had been working closely with the Alaska Native Tribal Health Consortium (ANTHC) on telemedicine efforts, which he believed would be successful. He shared that ANTHC had found that 40 percent of the telemedicine cases had avoided transportation services (i.e. airplane transportation). He stressed that telemedicine services needed to be increased; the department was working to enhance the capabilities.

Vice-Chair Fairclough inquired whether broadband would be related to telemedicine access for communities. She wondered whether ANTHC had solved the issue. Commissioner Streur replied that the tribal partners had stepped up in terms of broadband capabilities. The issue had not been solved, but progress had been made. He commented on the Yukon-Kuskokwim Health Corporation's ability to communicate with Anchorage and state offices. He summarized that the area may or may not need more development depending on the interface between the department and the entities.

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Vice-Chair Fairclough noted that the Department of Education and Early Development (DEED) legislative subcommittee had been told that DEED was currently working on and reviewing a broadband study. She wondered if it would include existing gaps for the legislature to take a look at.

Commissioner Streur spoke to the third method of controlling Medicaid spending: controlling what we pay providers to deliver those services or products (page 15). He relayed that the effort to control payments to providers was "wildly unpopular" at present. He detailed that controlling rates in Alaska was complex due to the state's large size and its range in unique services varying in rural and urban areas. He communicated that it was necessary for the department to look at the issue constantly. He emphasized that Medicaid rates in Alaska were approximately 140 percent of Medicare rates compared to the Lower 48 where Medicaid rates were 66 percent of Medicare rates.

Vice-Chair Fairclough asked for verification that the Medicaid rates were 144 percent of Medicare rates in Alaska. Commissioner Streur clarified that the figure was 140 percent.

Commissioner Streur communicated that the state paid very well. He discussed that in the past he had attempted to move the state to a cost-based system. He opined that many of the payment systems had not been rational; it had not been possible to determine that the state was receiving good value for what it paid. He discussed conducting a balance against the Medicare rate, nursing homes versus assisted living facilities, or comparing Alaska to other states. The department was looking at the issue. He believed the cost-based rate was a great way to determine what it truly cost to provide care. The question about how much profit should be made had been a robust conversation over the past several months.

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Vice-Chair Fairclough asked whether the 66 percent figure related to Medicaid and Medicare rates in the Lower 48 was

an average. She wondered whether a comparison had been made between Alaska other geographically similar states such as Montana or Wyoming. Commissioner Streur responded in the affirmative. He explained that in the Lower 48 on average Medicaid rates were 66 percent of Medicare rates. Alaska was the second highest paying state (some would argue that Alaska was the highest paying state). He believed Wyoming was the closest comparison to Alaska in terms of payments.

Vice-Chair Fairclough wondered which state paid the highest Medicaid rates. Commissioner Streur believed it was an eastern state. Co-Chair Meyer noted that DHSS staff communicated that the state paying the highest Medicaid rates was Massachusetts.

Co-Chair Meyer referred to the term "medical tourism." He wondered if the term was used in Alaska to refer to insurance companies encouraging individuals to receive medical procedures out of state due to high costs in Alaska.

Commissioner Streur responded in the affirmative. He detailed that there were substantial rate differences in medical procedures such as hip, knee, and heart surgeries. Specialty services were much higher in Alaska than in the Lower 48. He added a Medicaid recipient could receive services in the state of Washington for approximately 60 percent of the cost in Alaska; however, the preference was to keep individuals close to home.

Co-Chair Meyer acknowledged the importance of supporting in-state business, but understood the need to negotiate the large cost differences.

Commissioner Streur continued to discuss that the department was moving all providers to a cost-based system, or if Medicare rates were available, to a Medicare adjusted rate (page 15). Providers would be paid a certain percentage above the Medicare rate; as Medicare fluctuated the payments to providers would fluctuate as well (the process was currently used with physician services). He relayed that each provider community had its own advocacy group; the groups were vocal and were actively involved in any DHSS regulation promulgation process. He had worked to open the regulation hearing process as much as possible to allow for public comment. He had not yet received clearance to hold open working groups with providers. He remarked

that he almost had to remove a regulation off the table to have the ability to meet with groups on the regulation. He continued to work with the Department of Law to have some give and take on the issue.

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Commissioner Streur shared that DHSS continued to partner with provider groups to learn about their suggestions and hot button issues. The department also looked at best practices in other states and pricing models in other states. Additionally, DHSS considered acuity as it looked at home and community-based services, assisted living home services, and behavioral health services; an acuity mix made it much easier to price the cost of care.

Senator Hoffman relayed that the prior year the Senate Finance Committee had initiated the assisted living center in Anchorage that saved tens of millions of dollars over decades. He wondered whether a similar center was in consideration for Fairbanks or if ANTHC was considering the idea. Commissioner Streur did not know where ANTHC stood on the issue. The state was still working on determining how to get the value out of the center in Anchorage.

Commissioner Streur discussed needed technology improvements. He addressed the importance of having the ability to send an ultrasound from a village electronically to a larger community saved on transportation cost or the ability to transport a pregnant mother via plane to prevent a more significant issue with an unborn child. He addressed the need to increase care to tribal members within the tribal health system; approximately 40 percent of money paid by Medicaid for tribal health members was delivered within the tribal health system, which meant that the state only received 50 percent reimbursement. He would meet with tribal health directors to discuss working to make improvements. He relayed that the primary reason that services could not be provided in the communities was a lack of depth in providers. The department was working on items such as how to increase capacity and on specialties that would have sufficient utilization to justify the expense.

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Commissioner Streur addressed the fourth method of controlling Medicaid spending: controlling utilization (page 16). He believed that utilization was the area the department had the greatest capability of controlling. He communicated that the state did not do enough in measuring and assessing utilization; therefore, the state had begun to contract with outside entities to increase prior authorizations. He discussed that prior authorizations were challenging for physicians and other providers; however, the private system had used prior authorizations for years. The department was beginning to examine where savings could be found in services delivered. He provided a personal example related to duplicated x-ray services. He remarked that when a provider had invested in technology, they wanted to be able to pay for it. He stated that "in the private sector to do good you have to do well and in the public sector to do well you have to do good." He believed there was tremendous opportunity with prior authorization, retrospective review, and other. He continued to speak with the Alaska State Medical Association and Alaska Physicians and Surgeons on joining DHSS in the efforts. He stressed that the groups had been very involved in some of the savings efforts.

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Vice-Chair Fairclough inquired if DHSS had the ability to track some of the cost drivers. She wondered whether technology upgrades had been implemented. Commissioner Streur replied that the data warehouse was up and operational and provided DHSS tracking capability and to benchmark providers against each other. For example, he could compare procedure codes between gastroenterologists to determine outliers, best practices, and where underutilization may occur.

Vice-Chair Fairclough shared that she had recently broken her wrist and had been referred to a specialist. She explained that the initial doctor had taken an x-ray, which was used by the specialist. She was misdiagnosed and had to return to the specialist a month later where a second x-ray was done. The specialist relayed that the original x-ray had not had sufficient clarity. She wondered whether the department would be able to track similar situations when patients needed a second x-ray because the first one was not sufficient.

Commissioner Streur replied that the department would be able to track the situations. The department could look to follow-on therapies occurring that may result from misdiagnosis or misinterpretation of an x-ray or other radiology. The system was in the early stages and had gone into operation recently, but the capabilities were already significant. The issue related to quality of care, which he planned to discuss. He relayed that the new management information system had gone live on October 1, 2013. The department was paying claims, but it was still receiving too many rejections in the claims process; the system continued to be tweaked and would provide significantly increased capabilities from the previous antiquated system.

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Commissioner Streur relayed that DHSS continuously reviewed other states' best practices and was beginning to implement some changes to its capabilities. He spoke to the department's current cost control initiatives on pages 16 through 20. He discussed that DHSS was on track to save \$4.5 million in the current year in care management/case management of high utilizers of the emergency room and in-patient hospital stays. Savings came from management of patients including establishing a primary care physician, looking at chronic conditions, and determining ways to address drug-seeking behavior. He highlighted that the department had saved \$7.5 million with the substitution of generic medication in the past year; savings had been achieved by working with the physicians and prescribers. He elaborated that at one point the use of generic medications had been at 80 percent; however, that figure had been slipping back. He added that every 1 percent increase represented approximately \$800,000 in savings.

Commissioner Streur briefly mentioned that DHSS had not priced out psychiatric medication limits (page 17). He addressed that the department was working on strengthening third-party insurance recovery. He detailed that the department was working to recoup money (from third-party insurance) spent by Medicaid on patient care that insurance should have paid for.

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Commissioner Streur spoke to Medicaid fraud on page 24. He communicated that changes and the assistance DHSS was

receiving from the Department of Law Medicaid Fraud Control Unit were remarkable. He discussed increased prosecutions of individuals who had been inappropriately billing for services; the prosecutions continued to increase. He detailed that 29 individuals had been prosecuted a couple of months earlier. Efforts to identify "low hanging fruit" fraud continued. He provided an example of an individual billing Medicaid for personal care services when they had actually been out of the country for a month. He stressed that the costs added up to hundreds of thousands of dollars. Another example involved a nurse practitioner who had lost their license but continued to bill Medicaid. He believed erroneous billing was the largest challenge (page 25). Erroneous billing included billing at a higher procedure code than necessary, billing for a service that was misinterpreted as a higher level service, no documentation, billing for delivered service when patients did not show for an appointment, and other. He noted that the erroneous billing examples did not constitute fraud. As of August 2013 the Medicaid Fraud Control Unit had charged 53 cases with 13 convictions over the past six months. He noted that he was less concerned about the number in the prosecution and more concerned about people receiving the message to be more careful. He shared that many providers had joined the department in the attempt to bill for the right care, right service, right time, and the right person.

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Senator Dunleavy inquired whether providers received notification on fraud convictions. Commissioner Streur replied in the affirmative. The information was shared by the respective division and a press release was published. He added that the media picked up on the publications quickly.

Senator Dunleavy asked when a decision would be made on Medicaid expansion. Commissioner Streur replied that the governor had indicated that a decision would be made when he released the budget on December 11, 2013. He planned to meet with the governor in the upcoming week to provide an update and a report analysis. He stressed the importance of making the right decision. He pointed to disparity in available data. He stressed that significant variability existed in the numbers provided on the general fund cost of Medicaid expansion (such as \$90 million or \$240 million).

He discussed that one study had shown that Medicaid expansion would save the state \$67 million; combined with the expected \$90 million general fund cost the total was only \$23 million. He remarked that it was not a big effort to add insurance for 40,000 additional individuals for \$23 million, but the cost could end up being much higher (e.g. \$304 million).

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Senator Dunleavy remarked that some individuals would argue that the Obama administration had missed the mark in getting it right with its roll-out of the new healthcare plan. He discussed the implementation of large government programs that had specific goals; once the program was accepted the system was stuck with it. He noted that some would contend that a federal takeover of education had taken place.

Co-Chair Meyer asked whether Commissioner Streur could tell the committee anything about its budget for the upcoming fiscal year. He noted that the DHSS budget combined with the Department of Education and Early Development budget accounted for two-thirds of the state's operating budget.

Commissioner Streur expressed reluctance to respond given that the DHSS budget had not been cleared through the governor. He believed Medicaid would increase in the upcoming year after two relatively flat years. The data had not been fully vetted as the entire impact of the Affordable Care Act was not yet known.

Co-Chair Meyer looked forward to seeing the department's budget on December 11, 2013.

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ADJOURNMENT

[3:07:00 PM](#)

The meeting was adjourned at 3:07 p.m.