

SENATE FINANCE COMMITTEE
February 18, 2015
1:47 p.m.

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CALL TO ORDER

Co-Chair Kelly called the Senate Finance Committee meeting to order at 1:47 p.m.

MEMBERS PRESENT

Senator Anna MacKinnon, Co-Chair
Senator Pete Kelly, Co-Chair
Senator Click Bishop
Senator Mike Dunleavy
Senator Lyman Hoffman
Senator Donny Olson

MEMBERS ABSENT

Senator Peter Micciche, Vice-Chair

ALSO PRESENT

Sheldon Fisher, Commissioner, Department of Administration;
John Boucher, Deputy Commissioner, Department of Administration;
Randall Hoffbeck, Commissioner, Department of Revenue.

SUMMARY

^PRESENTATION: PUBLIC EMPLOYEES' RETIREMENT SYSTEM AND TEACHERS' RETIREMENT SYSTEM

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SHELDON FISHER, COMMISSIONER, DEPARTMENT OF ADMINISTRATION, discussed the PowerPoint, "Public Employees' Retirement System (PERS) Teachers' Retirement System (TRS) Update."

Commissioner Fisher looked at slide 1, "Agenda":

- I. Basic Facts
- II. Investments
- III. SB119/HB 385

Commissioner Fisher highlighted slide 2, "Section 1":

PERS/TRS BASIC FACTS

- A. Membership
- B. Organization
- C. Balance Sheet
- D. Health Cost Trends
- E. Funding Ratio History
- F. Employer Contribution Rates

Commissioner Fisher looked at slide 3, "Basic Facts: PERS Membership":

PERS:

159 Member Employers

3 Defined Benefit (DB) Tiers

31,267 retirees
18,447 terminated members entitled to future benefits
19,270 actives (74.55 percent)
68,984 total members

1 Defined Contribution (DC) Tier

9 retirees
7,876 terminated members entitled to future benefits
16,545 actives (46.2 percent)
24,430 total members

Senator Dunleavy queried the number of employees that were employees of the state, as opposed to municipalities and other entities. Commissioner Fisher replied that there was approximately 60 percent of former state employees. He did not have the number of active employees, but agreed to provide that information.

Senator Dunleavy restated that it was a 60 percent to 40 percent ratio. Commissioner Fisher replied that the ratio was for current retirees.

Senator Dunleavy wondered if the TRS was strictly a state issue. He asked for further information for TRS. Commissioner Fisher replied that TRS was the teacher's retirement system. He stated that it was historically

funded by the state, but they were mostly employees of the local school boards.

Senator Dunleavy requested a breakdown of active PERS employees. Commissioner Fisher agreed to provide that information.

Co-Chair MacKinnon queried the current system to provide the health care benefits. Commissioner Fisher replied that the nine retirees were not eligible for health care. He stated that the plan would be in place at a future date.

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Commissioner Fisher discussed slide 4, "Basic Facts: TRS Membership":

TRS:

58 Member Employers

2 Defined Benefit (DB) Tiers

12,077 retirees

3,044 terminated members entitled to future benefits

6,055 actives (59.0 percent)

21,176 total members

1 Defined Contribution (DC) Tier

0 retirees

1,777 terminated members entitled to future benefits

4,206 actives (41.0 percent)

5,983 total members

Co-Chair MacKinnon wondered if the University was a separate pension, and requested a breakdown of the contributions by state outside of the University's budget. Commissioner Fisher replied that it was a separate budget, and agreed to provide further information.

Co-Chair MacKinnon asked if the legislature had any input in where the money would be delivered, or if the legislature would only provide the funding.

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Co-Chair MacKinnon was attempting to determine the legislature's control of cost in negotiations for state benefits.

JOHN BOUCHER, DEPUTY COMMISSIONER, DEPARTMENT OF ADMINISTRATION, responded that the local school districts subscribed to the TRS plan. The state had control over the total benefit package, but the state did not negotiate wages for the employees.

Co-Chair MacKinnon wondered if the state controlled health care coverage. Mr. Boucher replied that the state did not control health care coverage.

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Commissioner Fisher looked at slide 5, "Basic Facts: Organization":

Department of Revenue: Treasury Division

Invests retirement system assets

Investment Advisory Committee

General Consultant

Staff

External Investment Management

Internal Investment Management

Alaska Retirement Management Board

Sets contribution rates, invests retirement system assets

Department of Administration: Division of Retirement and Benefits

Administers retirement and benefits system

Staff

Actuary

Third Party Administration

Commissioner Fisher discussed slide 6, "Basic Facts: Balance Sheet-Roll Forward":

PERS DB:

Assets (6/30/15 Roll-Forward): \$16,196,195,000
Accrued Liability (6/30/15 Roll-Forward):
22,554,455,000
Unfunded Liability: \$6,358,260,000
Funding Ratio: 71.8 percent

TRS DB:

Assets (6/30/15 Roll-Forward): \$8,078,743,000
Accrued Liabilities (6/30/15 Roll-Forward):
10,487,584,000
Unfunded Liability: \$2,408,841,000
Funding Ratio: 77.0 percent

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Senator Bishop wondered if the ARM Board felt that the \$3 billion appropriation was a "good move." Commissioner Fisher responded in the affirmative.

Senator Bishop shared that he had read a newspaper article that stated that the ARM Board did not support the \$3 billion. Commissioner Fisher stated that there was a universal expression of appreciation for the \$3 billion from the ARM Board. He remarked that there may be some individuals with differing views.

Co-Chair MacKinnon remarked that the person quoted in that article was taken out of context. She looked at slide 6, and noted that the anticipation of the funding ratio had yet to receive an additional deposit of \$1 billion separated in the same way between PERS and TRS. She wondered if that explanation applied to the "roll forward" cost in the slide. Commissioner Fisher replied that "roll forward" referred to the anticipated assets and liabilities in both PERS and TRS as of June 30, 2015. It included the \$2 billion TRS and \$1 billion in PERS.

Co-Chair MacKinnon noted that \$1 billion had yet to be deposited, so the slide referred to the anticipated forecast of the fund. She stressed that it took time to move the money, and it was anticipated that that last \$1 billion would be added around March 1, 2015. Commissioner Fisher agreed.

Commissioner Fisher discussed slide 7, "Basic Facts: Health Cost Trends." He remarked that health care costs was a major component to the unfunded liability. He noted that the far right column showed that the health care costs in 2014 was substantially higher than inflation at 9 percent. He shared that the state had kept the costs low, and he shared that the current year would have a zero percent increase in annual cost. He shared that the state recently selected AETNA as the third party administrator for its health care, to attempt to take advantage of AETNA's network. It was anticipated that there would be approximately \$50 million in savings versus the prior health administrator. He shared that there were some issues with the delivery of AETNA's service, but DHSS was working to ensure more timely delivery of service.

Commissioner Fisher addressed slides 8 and 9, "Basic Facts: PERS and TRS Funding Ratio History." The slide showed the funding ratios that existed prior to most recent \$3 billion investment. He remarked that the anticipated funding ratio for PERS and TRS would be 70 percent by June 30, 2015. He stressed that it was a remarkable improvement in the funding, as a result of the recent \$3 billion investment.

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Co-Chair MacKinnon wondered if there was an employee contribution option. She shared that she was willing to pay a monthly fee to help alleviate the unfunded liability. She also queried the amount of contribution money, and wondered how those funds were negotiated. Commissioner Fisher replied that negotiations were solid, and reflected in the collective bargaining agreements.

Mr. Boucher thought that the contribution rate was the same since the inception of the plan, and agreed to provide further information.

Commissioner Fisher presented slide 10, "Basic Facts: Contribution Rates."

Co-Chair MacKinnon announced that she had submitted a list of questions to the presenters. Local municipalities had asked for relief from different offices, and hoped that she would hear some information about the termination study. Commissioner Fisher replied that he had heard from many municipalities about the challenge of the termination study. Sometimes the termination studies result in a liability that make an otherwise good decision a challenge. He stated that he was working with the governor and OMB to evaluate different approaches. The department was attempting to find a balance between providing flexibility for the municipalities while ensuring the viability of the fund.

Co-Chair MacKinnon remarked that the budget eliminated many positions in the state. She wondered if there was a study for the effect of losing 300 contributing employees. Commissioner Fisher replied that there was no termination study. He stated that the study was not mandated, because there was no elimination of an entire classification.

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RANDALL HOFFBECK, COMMISSIONER, DEPARTMENT OF REVENUE, displayed slide 11, "Section 2: Investments."

Commissioner Hoffbeck looked at slide 12, "Investments: ARMB Assets Under Management." He announced that the Alaska Retirement Management Board was the fiduciary for the fund.

As of 12/31/2014, ARMB managed \$28 billion across 18 plans

PERS: \$15,793,229,447

Retirement Trust:
\$8,180,039,233

Retirement Health Care Trust:
\$6,857,761,831

Defined Contribution Retirement Plan-PERS:
\$533.183.662

Health Reimbursement Arrangement:
\$170,136,265

Retiree Medical Plan:
\$34,893,611

Occupational Death and Disability - PERS:
\$11,555,919

Occupational Death and Disability - Police
and Fire:
\$5,658,926

Teachers' Retirement System (TRS): \$7,421,696,010

Retirement Trust:
\$4,686,628,145

Retirement Health Care Trust:
\$2,441,460,292

Defined Contribution Retirement Plan - TRS:
\$224,927,793

Health Reimbursement Arrangement:
\$52,199,779

Retiree Medical Plan:
\$13,412,619

Occupational Death and Disability:
\$3,067,382

Judicial Retirement System (JRS): \$168,171,985

Defined Benefit Plan Retirement Trust:
\$141,816,866

Defined Benefit Retirement Health Care
Trust:
\$26,355,119

National Guard/Naval Militia Retirement System
(MRS): \$37,061,451

Supplemental Annuity Plan - SBS: \$3,355,137,119

Deferred Compensation Plan: \$798,722,221

Co-Chair MacKinnon queried the status of the JRS funding ratio. Commissioner Hoffbeck agreed to provide that information.

Commissioner Hoffbeck discussed slide 13, "Investments: Asset Allocation." He shared that the ARMB received capital market assumptions from Callan Associates. The assumptions included the expected rates of returns for each asset class over the upcoming ten years, and expected standard deviation on the returns. He shared that an efficient frontier was then developed which showed the likely return and standard deviation for the various asset class mixes. The frontier and the recommendations from the chief investment officer the board would then adopt a strategic investment plan with the target asset allocations. The slide displayed the target allocations. He noted that approximately 50 percent resided in domestic and global equities overall. He stated that the slide represented the PERS allocation, but the TRS allocation was similar. He remarked that the fund was aggressively invested. He noted that the actual asset allocation and target asset allocation were fairly similar.

Commissioner Hoffbeck highlighted slide 14, "Investments: US Stock Market Historical Return." The slide showed 226 years of returns from the U.S. Stock Market, and put into a bell curve. He noted that, since the selloff in 2008, there were six years of returns on the positive side of the bell curve. He specifically remarked that the 2013 return was 32.1 percent.

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Commissioner Hoffbeck addressed slide 15, "Investments: Fiscal Year Returns":

The 5 year annualized return for the period ending FY2014 was:

- 12.58 percent for PERS
- 12.68 percent for TRS
- 11.54 percent for APFC
- 18.84 percent for S and P 500

The 20 year annualized return for the period ending FY2014 was:

- 8.01 percent for PERS
- 8.09 percent for TRS
- 8.01 percent for APFC
- 9.79 percent for S and P 500

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Co-Chair MacKinnon wondered if there was a consideration for hiring a corporation to manage the assets. Commissioner Hoffbeck replied that there was no current formal consideration, until they saw the question. He explained that there was legislation in 1990 to form a corporation for the retirement fund, but it did not pass. The subject was examined a couple more times, but it was not found to be a more efficient way than the status quo. It would require additional administrative overhead, salary inflation, and some staff redundancies.

Co-Chair MacKinnon wondered if Commissioner Hoffbeck supported the Permanent Fund. Commissioner Hoffbeck replied in the affirmative.

Co-Chair MacKinnon remarked that the Permanent Fund held no GF dollars, and paid all of the dollars from Permanent Fund earnings. She expressed further analysis of the cost of the administrative overhead in the corporation. Commissioner Hoffbeck agreed to provide that information.

Commissioner Hoffbeck looked at slide 16, "Section Three: SB119/HB 385 \$3 Billion Appropriation to Pension Funds." He explained the function of SB 119 and HB 385, which were passed in the previous legislature.

Commissioner Hoffbeck addressed slide 17, "\$3 Billion Appropriation: PERS Pension." He felt that the previous DOR commissioner had made a prudent decision by transferring funds:

July 15 Transfer

Amount Transferred: \$333,333,333
Percent Return: 0.51 percent
Cash Return: \$1,700,762

November 13 Transfer

Amount Transferred: \$333,333,333
Percent Return: 0.68 percent
Cash Return: \$2,267,308

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Commissioner Hoffbeck discussed slide 18, "\$3 Billion Appropriation: TRS Pension":

July 15 Transfer

Amount Transferred: \$554,233,333
Percent Return: 0.32 percent
Cash Return: \$1,753,783

November 13 Transfer

Amount Transferred: \$554,233,333
Percent Return: 0.67 percent
Cash Return: \$3,739,538

Commissioner Hoffbeck highlighted slide 19, "\$3 Billion Appropriation: TRS Health":

July 15 Transfer

Amount Transferred: \$112,433,333
Percent Return: 0.36 percent
Cash Return: \$400,505

November 13 Transfer

Amount Transferred: \$112,433,333
Percent Return: 0.67 percent
Cash Return: \$758,316

Commissioner Hoffbeck looked at slide 20, "\$3 Billion Appropriation: Total":

July 15 Transfer

Amount Transferred: \$1,000,000,000
Percent Return: 0.51 percent
Cash Return: \$3,855,049

November 13 Transfer

Amount Transferred: \$1,000,000,000
Percent Return: 0.68 percent
Cash Return: \$6,765,163

Total Cash Return: \$10,620,212

Co-Chair MacKinnon recalled an article that addressed the decision to use a flat percentage versus a fixed cash amount. She wondered if the administration had proposed that idea. She remarked that the state would pay over \$200 million to meet the percentage obligation, which was major cost driver in the limited budget. She wondered if there was an actuary analysis to determine if another cash infusion was appropriate, or if it was more valuable to maintain the money in the savings account. She felt that the idea should be examined immediately, because the state would face a \$3.5 billion revenue shortfall prior to July 1, 2015. She stressed that there would be an additional \$3.5 billion to \$4 billion revenue shortfall, if the oil prices continued to decline. Commissioner Hoffbeck responded that DOR would have needed to pay \$1.175 billion for the required payment into the fund. The legislature's passage of the bills in the previous session allowed for the payments to reduce to \$256 million into the fund. He remarked that the cash infusion allowed for a substantial window moving forward. He stated that the idea for adding another \$1 billion required a comparison for the need of that \$1 billion. He explained that an additional \$1 billion in FY 16 would reduce the PERS from \$117 million to \$55 million.

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Co-Chair MacKinnon wondered if there were any new assumptions regarding interest rate returns or actuarial recommendations to modify the plan, and how the implementation would affect the plan. Commissioner Fisher replied that the actuarial assumptions were continually upgraded. The actuary came forward at the end of the previous year, and made a number of recommendations. The greatest impact was related to the mortality rate, and there was some impact associated with the assumptions around termination rates and salary scales. In total, the assumptions decreased the funding ratio by approximately 2 percent, but the assumptions were prior to the recent

investments. He felt that DOR was implementing the actuarial recommendations, so the presentation reflected the recommendations. He was not aware of additional actuarial recommendations.

Co-Chair MacKinnon stressed that people were living longer. She wondered if the roll-forward on slide 6 reflected the new assumption. Commissioner Fisher replied that the actuarial assumption included the revised mortality rates.

Commissioner Hoffbeck furthered that the revision was conducted every three years.

Co-Chair MacKinnon requested confirmation. She wanted to be confident in the assumption of an interest rate of return over a 30-year period of 6 percent. Commissioner Fisher replied that the rate of return of 8 percent.

Co-Chair MacKinnon remarked that the presentation was based on a group of assumptions.

Senator Dunleavy queried DOR's position regarding the return to a defined benefit program. Commissioner Hoffbeck responded that DOR did not have an official position. He shared that he did not believe that the state could afford a defined benefit program.

Senator Dunleavy wondered if buyout concepts were contemplated to remove people from the program. Commissioner Fisher asked for further clarification of the question. He wondered if Senator Dunleavy referred to active employees for early retirement, or a pension.

Senator Dunleavy stated that he wondered if there was a cash pension opportunity. Commissioner Fisher replied that there had been some consideration of a cash pension. He shared that the challenge was in an adverse selection. Some people may perceive that they may not take advantage of a long-term pension may take the buyout, and others may not take the pension because of health reasons.

Senator Dunleavy recalled a discussion at a local level for PERS and TRS, with no caps on the negotiations. He wondered if the administration had considered a cap on local negotiations. Commissioner Fisher replied that the local negotiations did not negotiate the retirement benefits, they focus on the wage and health benefits.

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ADJOURNMENT

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The meeting was adjourned at 2:36 p.m.