

SENATE FINANCE COMMITTEE  
February 2, 2017  
9:02 a.m.

9:02:31 AM

CALL TO ORDER

Co-Chair MacKinnon called the Senate Finance Committee meeting to order at 9:02 a.m.

MEMBERS PRESENT

Senator Lyman Hoffman, Co-Chair  
Senator Anna MacKinnon, Co-Chair  
Senator Click Bishop, Vice-Chair  
Senator Mike Dunleavy  
Senator Peter Micciche  
Senator Donny Olson  
Senator Natasha von Imhof

MEMBERS ABSENT

None

ALSO PRESENT

Sheldon Fisher, Commissioner, Department of Administration;  
Kevin Worley, Chief Financial Officer, Department of  
Administration; Pat Pitney, Director, Office of Management  
and Budget, Office of the Governor; Former speaker of the  
House Mike Bradner.

SUMMARY

PRESENTATION: PERS and TRS OVERVIEW

Co-Chair MacKinnon discussed the agenda for the day.

Senator Dunleavy introduced students from his district from American Charter School in the Meadow Lakes area, who were visiting the capitol to learn about the legislative process. He relayed that Ms. Huggins, wife to former Senator Charlie Huggins, was the principal of the school.

^PRESENTATION: PERS AND TRS OVERVIEW

9:04:35 AM

SHELDON FISHER, COMMISSIONER, DEPARTMENT OF ADMINISTRATION, discussed the presentation "Public Employees' Retirement system (PERS) - Teachers' Retirement System (TRS)" (copy on file). He relayed that he would move quickly through the early slides, and go more slowly as the slides advanced into financial information he thought would be of interest.

Commissioner Fisher discussed slide 2, "PERS/TRS - Organization," which showed a flow chart. He specified that PERS and TRS was managed through the Alaska Retirement Management (ARM) Board, which was staffed by the Department of Revenue (DOR) and the Department of Administration (DOA). He detailed that DOR was focused primarily on the advertisement of the assets, and worked with Callan investment consultants. He continued that DOA was focused on the administration of the benefits, and worked with actuary staff to make information available to the ARM Board.

Commissioner Fisher spoke to slide 4, "Basic Facts - PERS Chronology":

- January 1961: Established as a joint contributory plan
- 1975: Retiree Health Insurance with system-paid premiums added
- July 1986: Tier II established
- July 1996: Tier III established
- July 2006: Tier IV (DC) established
- July 2008: Cost Share

Commissioner Fisher recounted that in the past the state had previously had a multi-tier defined benefit plan, until Tier III closed in 2006 when the legislature initiated Tier IV. He indicated that under Tier IV members were assured a defined contribution, while the benefits received were dependent upon the returns achieved. He added that the members had materially greater control over the investments and management.

Commissioner Fisher continued discussing slide 4, indicating that in 2008 the state had accepted to fund part of the cost of the plan, and forthcoming slides would elaborate on the subject. He explained that as the unfunded liability had grown and the obligations on employers

presented a greater challenge, the state took on some of the funding.

[9:07:37 AM](#)

Commissioner Fisher displayed slide 5, "Basic Facts - Membership - PERS (as of 12/31/2016)":

- 157 Member Employers
- 3 Defined Benefit (DB) Tiers
  - 32,733 retirees
  - 5,835 terminated members entitled to future benefits
  - 15,826 actives (44%)
  - 55,394 total DB members
- 1 Defined Contribution (DC) Tier
  - 11 retirees
  - 691 terminated members entitled to future benefits
  - 19,377 actives (56%)
  - 20,079 total DC members

SOURCE: Division of Retirement and Benefits.  
Membership Statistics as of 12/31/2016

Commissioner Fisher pointed out that after 2015, there was more employees in the defined contribution tier than in the defined benefit tiers.

Senator Micciche inquired about average costs per capita and types of plans in other states. He wondered how other entities managed the liability of retirement systems. He relayed that he would send more exacting questions through email.

Commissioner Fisher relayed that most states had moved away from defined benefit programs, and most had a defined contribution or hybrid plan to split the liability and risk. He described hybrid plans, in which a portion of the plan was a defined benefit and a portion was a defined contribution. He added that there were benefits associated with the defined benefit plan, such as a more efficient use of capital.

Commissioner Fisher reported that one of that largest issues was that an individual approaching retirement moved out of the higher-returning but volatile asset classes and moved into a more conservative asset allocation, which

resulted in a lower return. Thusly some states had gone to a hybrid plan to try to maximize returns while minimizing the risk to the state.

Senator Micciche clarified that he was interested in cost per capita, exposure, and how states looked at unfunded liability. He was unsure if Alaska was similar to other states or was an extreme outlier with the state's unfunded liability and future exposure.

Commissioner Fisher relayed that the PERS plan was funded at about 78 percent, and the TRS plan was funded at about 82 percent. He specified that the average funding for public plans was about 74.5 percent, and therefore Alaska was a bit above average. He recalled that there were only two plans in the country that were fully funded, in the states of South Dakota and Wisconsin. He thought the best plans in the country were about 90 percent funded.

Commissioner Fisher relayed that the state's unfunded liability, on a per capita basis, was among the highest in the country. He noted that the state constitution protected retirees from a diminishment of the level of benefits. He noted that the Supreme Court had established guidelines, and it was very difficult for the state to reduce benefits to retirees.

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Co-Chair MacKinnon referred to an analysis given by the state's debt manager the previous day. She referred to credit rating agencies. She indicated that the committee had a great deal of interest pertaining to the huge unfunded liability. She referred to a slide from the previous day that showed for 2015 PERS was at a 67 percent funding ratio; and TRS was at a 76.9 percent funding ratio, which was improved from 2014. She asked Commissioner Fisher to restate the PERS and TRS funding levels, and wondered if the numbers for health insurance and retirement liability were blended.

Commissioner Fisher accelerated to slide 17, "PERS/TRS Basic Facts -Health Cost Funding Ratio," which depicted a table showing PERS and TRS pension and healthcare liabilities for 2014 and 2015. He pointed out the 59.7 percent pension liability for PERS in 2014; and informed that of the \$3 billion payment that was made to the state's

unfunded liability, \$1 billion was contributed to PERS. With the additional contribution, the funded ratio had increased to about 67 percent the following year.

Commissioner Fisher continued to discuss the table on slide 17, and highlighted that between 2014 and 2015; there was an improvement in the defined benefit health care unfunded liability, which went from 87 percent to nearly 100 percent. The improvement was a result of having returns better than what had been forecast. He thought the actuaries had been using a conservative set of assumptions, and the department had been working to better manage healthcare growth. He noted that the 78 percent (total funded ratio) was a blend between the pension and the healthcare liability.

Co-Chair MacKinnon wanted to provide greater clarity. She had wondered if there had been a split in the \$3 billion deposit to the system. She referred to the ARM board, and asked if it split the deposit further.

Commissioner Fisher explained that a modest amount of the bulk deposit had gone into healthcare. Of the \$3 billion, \$1 billion had gone into PERS, all of which had gone into the pension. Of the \$2 billion that had gone into TRS, about \$1.67 billion went into the pension, and about \$330 million had gone into health. He offered to provide precise numbers at a later time. Out of the \$3 billion, a little more than 10 percent went toward health care in TRS.

Co-Chair MacKinnon asked if the split was an internal determination of the ARM board.

Commissioner Fisher answered in the affirmative, and stated that the decision was based on a recommendation from the actuary.

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Senator von Imhof thought that 2015 was a snapshot in time, and asserted that the funded ratios changed each year as the liabilities and actuarials changed. She assumed that the next slide would indicate how the funding ratios dipped.

Commissioner Fisher answered in the negative, and furthered that he had wanted to highlight the risk the state was

facing. He elaborated that the state's fiscal year ended in June, at which time the actuary took the financial statements and produced an evaluation to present to the ARM board in its March meeting. He indicated that in March of the current year, the numbers from 2016 would be presented to the ARM board and then there would be a roll forward of the data.

Commissioner Fisher stated that periodically (every four to five years), the ARM board and the actuaries went through a detailed review of all the assumptions. He did not want to prejudge, but thought there was more risk that the unfunded liability would grow than shrink. The ARM board was operating on a return assumption of 8 percent, which was on the high end for pension plans. There had been ongoing discussion within the ARM board that the assumption should be reduced. He had reviewed an analysis that listed the average return assumption for public pension funds at 7.6 percent. He stated that there was no pension plan with an assumption higher than 8 percent. Additionally, the board would review the mortality rate.

Commissioner Fisher pointed out other factors that influenced the contribution rate, including a potentially smaller size of government, which could affect the contribution ratio. He wanted to make the legislature aware that the numbers being presented were accurate as of 2015, but there was a risk that the unfunded liability or state assistance would grow. There would be upcoming slides that addressed the subject.

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Senator von Imhof stated that eventually she would like to see an actuarial liability valuation versus the market value evaluation.

Commissioner Fisher explained that that actuary smoothed the assets over a 5-year period, which had been advised as a best practice to minimize volatility and allowed the legislature to have more consistency in the state assistance payment. He wondered if Senator von Imhof was asking about an un-smoothed asset valuation number.

Senator von Imhof asked for a later conversation to clarify her question.

Commissioner Fisher agreed.

Vice-Chair Bishop asked about the declining numbers of participants due to budget cuts and attrition. He asked about figures on slide 5.

[9:23:15 AM](#)

Commissioner Fisher showed slide 6, "Basic Facts - PERS Contribution Rates":

Defined Benefit

Employee:

- 7.50% Peace Officer/Firefighter
- 6.75% All Other employees
- 9.60% School District Alternate Option

Employer:

- 22% Cost Share

State:

- State on - behalf 4.14%

Defined Contribution

Employee:

- 8% All Employees

Employer:

- 5% Investment Account
- 1.18% Health Care
- 0.49% Occupational Death and Disability - Peace Officer/Firefighter
- 0.17% All Others
- HRA - flat dollar, 3% of all PERS/TRS average annual compensation

Commissioner Fisher pointed out that under defined contribution, the employee made an 8 percent contribution, and the employer made between a 5.25 percent and 5.75 percent contribution. The range of .49 percent was the occupational death and disability contribution for peace officers and fire fighters, which had a higher contribution rate. Anything beyond the contribution was to cover the unfunded liability.

Vice-Chair Bishop reiterated his question about individuals still in Tiers I, II, III; and wondered if the individuals were funding the defined benefit plan.

Commissioner Fisher answered in the affirmative.

Vice-Chair Bishop asked if the funds were comingled.

Commissioner Fisher replied that the state paid 22 percent for every employee in either plan type. A portion of the funds were comingled, and a portion was segregated.

Vice-Chair Bishop indicated that he wanted to have further discussion on the matter outside of the meeting. He requested that Commissioner Fisher research the hybrid plan in the State of Nebraska.

Co-Chair MacKinnon looked at slide 6, and understood that the employer contribution was 22 percent; PERS had state employee members as well as others. She thought there had been concern about the blending of funds. She thought there would be potential for discrimination toward those under the defined benefit plan if the state defined the contribution at a lower rate. She thought the problem was more complex than the dollar amount. She referenced employers who owned 40 percent of the liability, and had not paid a fair share.

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Commissioner Fisher continued to discuss slide 6, adding that under the defined benefit the employer contribution was 22 percent (fixed by statute). The state covered the gap between what was actually required to fund the plan versus the 22 percent, which currently equated to a little over 4 percent.

Vice-Chair Bishop expressed concern about a termination study. He understood there were community concerns.

Commissioner Fisher stated that termination studies were a complex subject, with an issue that the employer had a share of the unfunded liability that needed to be serviced. If an employer made radical changes to its structure, there would need to be accountability. He thought it was most challenging for smaller municipalities, and made it difficult to downsize. The administration had supported the concept of considering reform to termination studies.

Commissioner Fisher continued that part of the way that the determination liability was calculated assumed a person left state employment. If a person left a municipality and

went to another municipality or state job and was still in the system, he thought it was a fair point that it could be appropriate to make an adjustment. He stated that the subject had come to his attention, and the administration was prepared to examine the matter to see whether an adjustment was appropriate.

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Senator Micciche asked Commissioner Fisher to describe the benefit under the defined contribution side that covered occupational death and disability for peace officers and fire fighters.

Commissioner Fisher explained that the benefit offered was a 40 percent salary replacement, and that the ongoing discussion pertained to healthcare, which was not currently provided to survivors.

Senator Micciche asked if the state was able, under the state defined contribution plan, to have a separate category that was related to a salary replacement for peace officers and fire fighters.

Commissioner Fisher answered in the affirmative. He added that it was also possible to do the same with healthcare.

Senator Olson asked if there was a specific community that wanted to leave the PERS system. He referred to the community of Galena in his district, which had decreased population and revenues, and asked what options there were for the community to stay solvent.

Commissioner Fisher noted that the issue was a perfect example of how the administration wanted to work with the legislature to provide options for such communities. He did not think it was helpful for the system to burden the community. He thought it was a question of a relatively modest amount. He thought it would require a change in statute to be able to accommodate a different option.

Senator Olson asked if Commissioner Fisher was stating that the department could not make a change without changing statute.

Commissioner Fisher answered in the affirmative.

Co-Chair MacKinnon relayed that her district had also requested the elimination of a termination study. She asserted that it was also challenging for larger cities, and thought there was an equity issue if other areas with taxing authority were released from obligation.

Commissioner Fisher agreed that it was a complicated topic.

Commissioner Fisher showed slide 7, "Teachers' Retirement System (TRS)."

Commissioner Fisher spoke to slide 8, "Basic Facts - TRS Chronology":

- March 1945: Established
- 1951: TRS excluded from Social Security
- 1955: Became a joint contributory plan
- 1966: Retiree health insurance (RHI) added
- 1975: System-paid premiums for RHI
- 1990: Tier II established
- 2006: Tier III (DC) established

Commissioner Fisher reviewed slide 9, "Basic Facts - Membership - TRS (as of 12/31/2016)":

- 57 Member Employers
- 2 Defined Benefit (DB) Tiers
  - 12,731 retirees
  - 756 terminated members entitled to future benefits
  - 5,240 actives (51%)
  - 18,800 total DB members
- 1 Defined Contribution (DC) Tier
  - 2 retirees
  - 383 terminated members entitled to future benefits
  - 5,072 actives (49%)
  - 5,457 total DC members

Commissioner Fisher pointed out that TRS had an almost 50/50 split between active defined benefit members and active defined contribution members. He expected the numbers would flip in the following years.

Commissioner Fisher showed slide 10, "Basic Facts - TRS Contribution Rates":

Defined Benefit

Employee:

- 8.65%

Employer:

- 12.56% Cost Share

State:

- State on-behalf 15.46%

Defined Contribution

Employee:

- 8% All Employees

Employer:

- 7% Investment Account
- 1.05% Health Care
- 0.00% Occupational Death and Disability

• HRA - flat dollar, 3% of all PERS/TRS average annual compensation

Commissioner Fisher noted that the employer contribution in PERS was 22 percent, and in TRS was 12.56 percent.

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Senator Dunleavy asked if Commissioner Fisher could explain why people in TRS were not in the Social Security system. He had received questions from his constituents about the matter.

Commissioner Fisher explained that Social Security had the ability for state entities to opt out of the system and replace it with a comparable system. The state had made the election, and rather than making the contributions into Social Security, it made the contributions into the TRS plan. He thought the decision was wise, and the kind of return the state could generate through investments was meaningfully better than the kind of return a person would get with an equal contribution into Social Security.

Senator von Imhof relayed that she also had the same question from her constituents. She shared that she paid into Social Security as well as a 401k. She asked if there had been a discussion about reintroducing Social Security and have it as a secondary retirement plan.

Commissioner Fisher explained that the state also had a Supplemental Benefits System (SBS), which was exactly like the contribution made to Social Security. The employer made half of the contribution, and the employee made half; which went in to the defined contribution account and vested over time. The funds were available to be invested as other assets. To his knowledge there had not been discussion about returning to the option of Social Security, which he considered a lesser option. He stated that SBS was not available to teachers. To his knowledge there had not been discussion about going back to Social Security.

Co-Chair MacKinnon asked Commissioner Fisher to determine if it was an option to return to Social Security. She thought that staying within the system was a one-time option. She did not want to raise false expectations with the public.

Commissioner Fisher stated that Co-Chair MacKinnon was correct, and thought it might be possible to combine systems, but it was not legally available to change back to Social Security.

Commissioner Fisher showed slide 12, "Retirement System - PERS/TRS Financial Information." He informed that he would discuss financial information, much of which he had already touched on. He Fisher reminded that the information was based on June 20, 15 numbers. The June 30, 2016 numbers would be available in about a month. He reiterated that the ARM Board and the actuaries would be going through a fairly detailed review of all assumptions that could impact some of the underlying numbers.

Commissioner Fisher noted that the financial information he would discuss would include both pension and healthcare. The PERS portion had pension assets of about \$16 billion, with liabilities of about \$20.5 billion, and an unfunded liability of about \$4.5 billion. On the TRS side, there were assets of about \$8 billion, liabilities of about \$9.7 billion, and an unfunded liability of about \$1.6 billion. The totals reflected the 73 percent funding level for PERS, and the 83 percent funding level for TRS.

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Co-Chair MacKinnon asked if there was \$5.5 billion in blended unfunded liability.

Commissioner Fisher stated that on a combined basis, there was about \$6.1 billion in unfunded liability.

Co-Chair MacKinnon discussed the 8 percent rate of return assumption, and knew there was historical data that supported achievement of an 8 percent return over a 30-year period. She thought 8 percent was on the high end of what pension plans were receiving for a rate of return.

Commissioner Fisher concurred. He continued that the inflation assumptions in the actuarial model were at 3 percent. Based on the last few years, the state had low returns as well as a low inflationary period. He reiterated that all the assumptions would be revisited in the coming year.

Co-Chair MacKinnon asked if the slides would address cashflow assumptions.

Commissioner Fisher answered in the affirmative.

Commissioner Fisher discussed slide 13, "PERS/TRS - ARMB Long Term Returns (through 6/30/2016)," which showed a data table. He pointed out that long-term, the plans had averaged a nearly 9 percent return; but more recent returns had been less.

Commissioner Fisher spoke to slide 14, "PERS/TRS - Basic Facts":

Defined Benefit Pension:

Fixed benefit amount from date of retirement to death  
Contributions + Investment Earnings = Benefits + Expenses

IF:

Actuarial assumptions are accurate.

IF NOT:

Unfunded liability is created.

Co-Chair MacKinnon pointed out that the reverse of what the slide described could also be true. She remembered a time when the system was reported to be overfunded, and the state had reduced its contributions.

Commissioner Fisher agreed.

Senator Micciche asked if Commissioner Fisher had meant to indicate that if assumptions were accurate, the unfunded liability would remain at only \$6 billion. He asked if the commissioner meant that if investment earnings dropped below 8 percent, then unfunded liability would increase.

Commissioner Fisher agreed with Senator Micciche's characterization, that as investment declined the unfunded liability would grow.

Senator Micciche pondered that at an 8 percent return, \$6 billion in unfunded liability would remain.

Commissioner Fisher qualified that the condition was true as of June 30, 2015.

[9:45:50 AM](#)

Co-Chair MacKinnon asked if the unfunded liability would begin to diminish if the programs achieved an 8 percent rate of return in combination with the state's continued contributions of the 22 percent.

Commissioner Fisher stated that the unfunded liability of \$6.1 billion dollars assumed achievement of an 8 percent rate of return over the duration of the fund. Over time, the unfunded liability would change as retirees grew, expenses were paid, retirees passed away, and the plan wound down.

Co-Chair MacKinnon remarked on the problem.

Senator Micciche thought that the scenario demonstrated that state payments would increase even if the 8 percent rate of return was achieved. He thought the slide was misleading, and it was possible to get the impression that there was not an existing unfunded liability even if the state was successful at 8 percent.

Commissioner Fisher stated he would revise the slide to be more careful.

[9:48:04 AM](#)

Commissioner Fisher highlighted slide 15, "PERS/TRS - State Assistance," which showed a data table reflecting the history of state assistant payments. He pointed out that

since 2006, the state had made contributions in excess of \$6.7 billion in to the fund; \$3 billion of which was associated with the 2015 contribution. He added that the the plan had also extended the amortization by another 9 years. He pointed out that in 2014 the plan had made a contribution of nearly \$630 million, and afterwards dropped to \$256 million. The change was a result of the \$3 billion contribution and the extension of the amortization.

Commissioner Fisher stated that contributions would grow and in the out years was projected to be in excess of \$450 million.

Senator Micciche discussed the extension of amortization. He thought an adverse effect had been increased payments to municipalities. He used the example of going from a 15-year mortgage to a 30-year mortgage.

Commissioner Fisher thought Senator Micciche's characterization had been accurate, and the amortization change had reduced the annual payment each year. Because employers were capped in contribution to 22 percent (under PERS); by extending it, the employers would pay the 22 percent for 25 years rather than 16.

Senator Dunleavy asked Commissioner Fisher to clarify his comment about payments in outer years.

Commissioner Fisher stated that over time as individuals retired and expenses grew, the state assistance payment would also grow. The forecast for 2027, for example, indicated that there would be a \$450 million state assistance payment.

Senator Dunleavy thought it was important to consider the future payments.

Co-Chair MacKinnon asked to take a pause and consider the slide that Senator Micciche had been referring to.

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AT EASE

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RECONVENED

Co-Chair MacKinnon referenced slide 17 from the previous day's presentation, "2017 Credit Review & State Debt Summary," as discussed by Deven Mitchell, Executive Director, Alaska Municipal Bond Bank Authority, Department of Revenue (copy on file).

Senator Dunleavy asked Commissioner Fisher to explain the out-year estimated total state debt payment for 2039, which was approximately \$880 million.

Commissioner Fisher assumed the numbers on the slide were correct, and noted that in nominal dollars in 2039, there would be an estimated payment of \$880. He thought it was important to recognize that the amounts listed were not in today's dollars, but were in future dollars.

Senator Micciche queried if the curve on the slide's chart would be relatively flat if it were adjusted to today's dollars.

Commissioner Fisher stated that the curve would be less steep if the funds were adjusted.

Senator Dunleavy guessed that the payment would be approximately \$500 billion if the funds were adjusted.

Co-Chair MacKinnon described the slide. She thought it was fair to state that there was a huge unfunded liability, and an estimated payment amount in the future. She relayed that the slide was reflective of nominal dollars, which the commissioner had suggested may be overstated from the perspective of today's dollar. She referred to the \$3 billion deposit in 2013 to the unfunded liability. She discussed the liquidity inside the fund, needed to meet the needs of pensions. She thought the issue was important and expressed concerns about future cash calls. She discussed the asset basis for the rate of return.

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Commissioner Fisher turned to slide 16, "PERS/TRS Basic Facts - Unfunded Liability," which showed a bar graph. He highlighted a decline in unfunded liability in 2014, associated with a practice of smoothing assets. In anticipation of the \$3 billion contribution, all the historically smoothed gains were recognized in 2014. Then a corresponding decrease between 2014 and 2015 was associated

with the \$3 billion contribution. He stated that the decline should not be viewed as a trend, and starting in 2015 the unfunded liability was expected to grow.

Commissioner Fisher spoke to slide 18, "PERS Basic Facts - Funding Ratio History (Based on Valuation Assets)," which showed a bar graph. He recognized that Co-Chair MacKinnon had acknowledged that between the years of 1996 through about 2001, the fund had an excess of assets over liabilities (based on actuarial assumptions). He thought the fairly substantial drop between 2001 and 2002 could be attributed to adjustments to actuarial assumptions combined with changes in market conditions.

Co-Chair MacKinnon noted that the state was significantly underfunded in 1979, and wondered what the legislature had done at the time to positively impact the unfunded liability.

Commissioner Fisher thought the time period was associated with some fairly strong market returns. He was not aware of whether the state also took action, and avowed to respond at a later time.

Co-Chair MacKinnon asked if Commissioner Fisher could provide the employee count at the time, and whether there was a trend in expanded employees.

Commissioner Fisher showed slide 19, "TRS Basic Facts - Funding Ratio History (Based on Valuation Assets)," which showed a bar graph. He highlighted the years of 1999 and 2000, where TRS was at or above being fully funded, as well as a similar decline as the previous slide.

[10:07:39 AM](#)

Commissioner Fisher turned to slide 20, "PERS/TRS Basic Facts - Contribution Rates," which showed two graphs illustrating contribution rates for PERS and TRS, respectively. He noted that the graphs showed the history of how the practice of state contribution had started. He highlighted that in 2007 and 2008, it had been forecast that the employer contribution would be going from the mid-20s percent to mid-50s percent. He explained that had the contribution percentage gone up to the mid-50s, for every dollar paid to a teacher, there would be a 55-cent contribution to the fund. He thought many school districts

had faced a significant challenge with the prospect, and the legislature decided to cap the employer contribution at 22 percent under the PERS plan, and at about 12.5 percent under the TRS plan.

Senator Micciche thought the state had not considered the feedback on the number of municipal employees. He noted that the state had no control over the costs, and wondered if it had been a part of the discussion at the time. He pondered that if the city became wildly successful from a new sales tax, and grew employees by a great number, the state would have no way to control the outcome.

Co-Chair MacKinnon recalled that the committee had discussed the matter when reviewing school debt reimbursement. She recalled that municipalities were accessing debt service - the state could not control it and had placed a moratorium.

Commissioner Fisher pointed out that now that the state was in a Tier IV defined contribution plan, if municipalities increased the number of employees it would help address the unfunded liability. Now that all employees were in a defined contribution category, it would not affect potential expenses of the fund.

Co-Chair MacKinnon went back to slide 5, and referenced the 5,800 terminated employees that were entitled to future benefits.

Commissioner Fisher affirmed that Co-Chair MacKinnon was correct, and if the city rehired one of the 5,800 individuals there was an opportunity for the liability to grow.

Co-Chair MacKinnon stated that it would be discriminatory to consider the effect upon hiring of the employee.

Senator Micciche stated that in his legislative career he had made a practice of hiring Tier I retired employees. He did not think it had an impact on the benefits to the state after they were retired as a Tier I employee.

Commissioner Fisher clarified that he intended to say that if one hired a Tier III employee that had 15-years of service left, the Tier III benefits grew the longer the individual was a state employee. He clarified that his

earlier comments had been predicated on the assumption that new employees would be Tier IV; the chair had reminded that was not necessarily true, and some subset could be within the defined benefit program.

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Senator von Imhof pondered the 19,377 active employees in the defined contribution plan and considered slide 20. She asked if the state was paying within the shaded areas of the two graphs on the slide.

Commissioner Fisher answered in the affirmative, and indicated that the rate that was on the slide was the true cost to deliver the defined benefit plan to the PERS members that had defined benefits. The state made a 22 percent contribution on behalf of Tier IV employees. He noted that roughly half of the contribution amount went to pay the past service amount.

Senator von Imhof asked about the shaded blue area on the PERS graph.

Commissioner Fisher indicated that the shaded blue area represented the state assistance payment; which was the difference in what the employer was paying (22 percent), and the true cost required to keep the plan solvent.

Senator von Imhof asked if the state paid any of the amount for the 19,377 active employees in the defined contribution plan.

Commissioner Fisher indicated that the state payment assistance was not calculated on a per-employee basis. He explained that when the ARM Board and the actuaries figured out what was required, and looked at the contribution, the state picked up the difference. The amount was not tied to whether the state had employed those with defined benefit or defined contribution plans.

[10:16:15 AM](#)

Senator von Imhof asked if municipalities hired many new employees, would the amount of state payment assistance increase due to the increase of overall cost of going into the plan.

Commissioner Fisher replied that the cost was dependent upon the nature of the employees that were hired. If a municipality were to hire 100 percent Tier IV employees, the state's on-behalf payment would decline as a result of more employees for whom the employer was making a 22 percent contribution. If the municipality were to hire 100 percent defined-benefit employees, the blue shaded area on the graph would probably grow. He recounted that on average, increasingly newer employees tended to be Tier IV. He offered to run some scenarios for consideration.

Co-Chair MacKinnon asked if it was fair to say that the administration had been trying to limit the growth on healthcare costs because it was an area the state could control in the blended pension system. She used the example of her own benefits through state employment, and noted there was no longer a third "deluxe" plan available.

Commissioner Fisher answered in the affirmative. He reiterated that the state had a constitutional obligation to continue funding a set of benefits to retirees. On the pension side, the benefits were well-defined and difficult to change. On the healthcare side, the actual benefit delivered were defined rather than the dollar amount. If the state could work to deliver the same benefit at a lower cost, it could save the plan money and help minimize the unfunded liability. The department was also trying to minimize the healthcare costs for active employees.

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Co-Chair MacKinnon stated that it was not possible to go back and change constitutionally protected benefits.

Commissioner Fisher concurred.

Co-Chair MacKinnon wondered if an employee's pension was calculated on the highest 3 years of earnings, instead of the total life of earnings.

Commissioner Fisher answered in the affirmative, and qualified that the calculation varied depending upon the category and the tier of the employee. For Tier I, the highest 3 years of earning were considered; while for Tier III, the highest 5 years were considered.

Co-Chair MacKinnon asked if the administration was trying to control overtime costs by trying to use lower-cost employees for overtime. She wondered if rules adopted inside of contracts allowed for senior state employees to have the first chance at overtime. She wondered if it was a measure that the administration could control.

Commissioner Fisher was unsure of the precise regulations surrounding the matter, but thought it was generally true that departments worked hard to try and control overtime. He reminded that over 40 percent of PERS members were not state employees. He thought there was an opportunity for people to take assignments that had more premium pay during the final years of state work to bump up retirement benefits.

[10:22:04 AM](#)

Co-Chair MacKinnon asked the administration to review policies related to overtime and transferring from one agency to another that may have cost of living differentials to drive up pensions. She qualified that she was not trying to dissuade long-standing employees. She used a fictitious example of an individual who made a small salary as a school board member for 10 years, then got a much higher paid job that skewed pension benefits.

Commissioner Fisher informed that it was possible for the state to control overtime or premium pay, but could not change the terms of Tier I, II and III plans.

Co-Chair MacKinnon asked if the state had adopted different retirement periods. She believed for police and fire fighters there was a 20-year retirement period; and there was a longer period the state paid for in benefits than it received in contributions.

Commissioner Fisher answered in the affirmative.

Co-Chair MacKinnon emphasized that the state supported law enforcement officers and fire fighters, but pointed out that the policy affected the unfunded liability.

[10:25:16 AM](#)

Senator Micciche discussed the state's exposure, and dependence upon an 8 percent return. He discussed the

different outcomes based on lower rates of return. He wondered if the administration was compiling a list of things for the legislature to consider to reduce potential future liability to the state. He thought a comprehensive approach was needed, and wanted state employees to have competitive options for retirement. He wondered if the committee should request such a list from the department.

Commissioner Fisher conveyed that he would be pleased to work with the legislature to consider options. He clarified that the current liability, to a large extent, was defined by past commitments, as well as factors beyond the state's control (such as mortality and return assumptions). He thought there might be an option to consider a retiree buy-out, which had had mixed success. He restated that the state was fairly limited in its ability to redefine the package it was offering to retirees based on what commitment had been made, as well as the limitations in the constitution. He emphasized that it was important to look at healthcare costs, an area where the state could continue to meet its obligations to retirees while still reducing the cost of delivery.

Senator Micciche was aware of the constitutional requirement that the state not diminish benefits to retirees; but wondered about Tiers I, II, and III returning to work. He wondered about an option that state retirees remain in retirement. He thought it was important to consider all of the options for future liabilities.

Senator Olson asked Commissioner Fisher about the 5,835 terminated members entitled to future benefits. He wondered if benefits of the employees would increase if they returned.

Commissioner Fisher stated that if the terminated employees returned to work and had more years of service, the benefits would increase.

Senator Olson asked about the mentality of the administration in regard to other retirement programs.

Commissioner Fisher stated that the administration had not considered creating a new tier of jurors.

[10:30:42 AM](#)

Vice-Chair Bishop wondered, given that PERS and TRS was managing the system for current employees, if there would be value in separating out the functions and missions of the ARM Board that considered the interests of members who were retired. He emphasized the idea of examining reinstatement of the Retired Public Employees Board. He referred to the department's ongoing discussions on the matter, and relayed that he had been meeting with constituents in Fairbanks on the topic as well.

Commissioner Fisher conveyed that the department had ongoing dialogue with retirees, and intended to adopt regulations to establish an advisory board of retirees to assist the department in making choices relating to health care benefits in particular. He specified that it was possible to change the nature of the plans (consistent with the Supreme Court opinion) as long as it was done in a balanced manner. The department wanted to work with retirees in considering the changes in order to have input moving forward. He was optimistic that the change would happen during the current legislative session.

Commissioner Fisher discussed slide 21, "Projected Retirement Population Growth," which showed a line graph of retirees over the years 2016 through 2036, when the plan projected the last person would retire. He pointed out the peak on the line graph between the years of 2026 and 2028.

Commissioner Fisher spoke to slide 22, "Benefits - PERS/TRS," which showed a graph that depicted how projected retirement population growth affected payments. He noted that over the next 70 years there would be \$140 billion in benefits payments. The benefits paid peaked in the year 2039, and began to decline.

[10:33:54 AM](#)

Senator Micciche asked if the lump of benefit risk on slide 22 was marketable.

Commissioner Fisher wondered if Senator Micciche was inquiring if the state could go to a third party to ask it to take the risk.

Senator Micciche stated that a third party would be gambling on the fact that the actual exposures were

somewhat lower than the curve. He wondered if the marketability was worth considering.

Commissioner Fisher noted that the administration had not considered looking for a third party to take the risk. He thought the question was largely dependent upon considering that there was another entity that could manage the funds and achieve a better return than the state. He thought there was also a risk that the exposures were higher than what was estimated. He thought that generally third parties wanted to be compensated for taking the risk. He thought the state had done a good job managing the plan and had enjoyed good returns.

Senator Micciche thought there was a combination of considerations on reducing the risk: one was better returns, and the second was managed care to bring down healthcare costs. He thought there was combinations of risk to consider.

Commissioner Fisher was not aware of someone in the position to assume both the financial risk and returns associated with the set of assets, and to effectively manage the healthcare costs.

[10:36:57 AM](#)

Co-Chair MacKinnon thought there were existing trusts that were trying to create a market for buying improved healthcare outcomes. She discussed pension buyouts, and thought there was a bill in the legislature that pertained to early retirement and buyouts.

Senator Micciche complimented the commissioner and hoped he was not becoming bureaucratic. He pondered a third-party taking the risk.

Co-Chair MacKinnon asked if Commissioner Fisher had a response regarding to the idea of a buyout.

Commissioner Fisher relayed that the administration had looked at the scenario, and observed a range of successes in the marketplace. He thought there was a risk in designing the program to avoid selection bias; meaning that those who tended to have a low life expectancy would tend to take the buyout, and those with an expectation of a longer life expectancy would not. He stated that the

department would be more proactive in coming back with a set of options and more studied consideration of the likelihood of success.

[10:39:53 AM](#)

Senator Dunleavy was concerned that people were not working hard enough to reduce the size of government and curtail spending. He felt as though the legislature was being directed toward revenue enhancements. He mentioned insurance pooling. He stated that some of the legislature would be hesitant to approve revenue enhancements (taxes) until it was felt that the administration had exhausted every single possibility to try and address the deficit. He thought it was somewhat frustrating that the conversation had turned to taxing Alaskans. He wished there was more of an attempt at exhausting the collective imagination in how to reduce the size of government before additional taxation.

Commissioner Fisher relayed that the department had a fairly long list of initiatives underway (such as shared services, IT integration, focus on healthcare cost) to reduce spending. It had tried to prioritize those activities that had the greatest likelihood of returning a benefit to the state. He was happy to share the list of initiatives for consideration as to whether it was prioritized appropriately. He shared a concern that the department was at risk of not being able to achieve what it had taken on, rather than having excess capacity.

Senator Olson discussed health care costs, and did not see a graph that reflected the requirement of individuals over 65 to go on Medicare.

Commissioner Fisher stated that the department did not have a graph that reflected the information. The plan assumed that when a person turned 65, state healthcare became secondary to Medicare. He stated that most of the healthcare spend was before retirement and age 65, and the retiree plan was spending about \$500 million per year on healthcare.

[10:45:05 AM](#)

Co-Chair MacKinnon asked if there were re-opener clauses in the state's negotiated contracts.

Commissioner Fisher was not aware of any reopener clauses in the contracts.

Co-Chair MacKinnon wondered if there was a mutual benefit to reopening contracts.

Commissioner Fisher stated that it was always possible to invite the union to the bargaining table, but it did not have an obligation. There had been a past discussion about reopening contracts in the event of a particular oil price scenario, but an agreement had not been reached.

Co-Chair MacKinnon asked if the practice was standard procedure for an employment contract.

Commissioner Fisher stated that his experience in the private sector as well as in his current position was that reopener clauses were quite unusual.

Co-Chair MacKinnon contemplated the extreme idea be to go to the people of Alaska and ask to streamline health benefits as a constitutional amendment, and have retirees' health benefits mirror whatever was being provided for the current working state employees.

Co-Chair MacKinnon pondered the state's revenue shortfall and the rate of return for the current pension asset allocation.

Senator Micciche believed that collectively, the difference (from diminished rates of return) could be tens of billions of dollars.

Co-Chair MacKinnon relayed that the administration had been evaluating the use of pension obligation bonds. She mused about a potential course of action in which municipalities could buy out of their 40 percent of the financial reasonability, which would provide a cash infusion for the plan and reduce the municipalities' future obligation.

Co-Chair MacKinnon discussed the agenda for the following Monday.

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ADJOURNMENT

10:49:53 AM

The meeting was adjourned at 10:49 a.m.