

SENATE FINANCE COMMITTEE
February 14, 2018
9:03 a.m.

[9:03:25 AM](#)

CALL TO ORDER

Co-Chair MacKinnon called the Senate Finance Committee meeting to order at 9:03 a.m.

MEMBERS PRESENT

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

MEMBERS ABSENT

None

ALSO PRESENT

Leslie Ridle, Commissioner, Department of Administration;
Ajay Desai, Director, Division of Retirement and Benefits,
Department of Administration; Mike Barnhill, Deputy
Commissioner, Department of Revenue.

SUMMARY

^PRESENTATION: PERS TRS OVERVIEW - DEPARTMENT OF
ADMINISTRATION

[9:04:28 AM](#)

LESLIE RIDLE, COMMISSIONER, DEPARTMENT OF ADMINISTRATION, introduced herself, her staff, and members from other departments that were present to provide support information if necessary.

Commissioner Ridle discussed the presentation "Public Employees' Retirement System (PERS) Teachers' Retirement System (TRS) 2018 UPDATE" (copy on file).

Commissioner Ridle displayed slide 2, "Organization - PERS / TRS," which showed a flow chart of how the duties were split between departments. She detailed that the Department of Revenue (DOR) did all the investment of retirement assets and took care of general consultants and staff that did external and internal investment management. The Department of Administration (DOA) administered the retirement and benefits systems and managed actuaries, as well as had a third-party administrator for the health and retirement system. The Alaska Retirement Management (ARM) Board set contribution rates, invested funds, and oversaw all retirement system assets.

[9:06:40 AM](#)

Commissioner Ridle read to slide 3, "Public Employees' Retirement System."

Commissioner Ridle spoke to slide 4, "Chronology - PERS":

- 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 with 22% employer contribution rate

Commissioner Ridle referenced slide 5, "Membership - PERS (as of 12/31/2017)":

- 157 Member Employers
- 3 Defined Benefit (DB) Tiers
 - o 34,750 retirees
 - o 5,614 terminated members entitled to future benefits
 - o 14,431 actives (41%)
 - o 54,795 total DB members
- 1 Defined Contribution (DC) Tier
 - o 21 retirees
 - o 991 terminated members entitled to future benefits

- o 20,458 actives (59%)
- o 21,470 total DC members

SOURCE: Division of Retirement and Benefits.
Membership Statistics as of 12/31/2017

Commissioner Ridle detailed that the 34,750 retirees listed on the slide included beneficiaries and dependents of the retirees. The 5,614 terminated members were people who had left the system, but the state still had an obligation if the members retired from the state system.

[9:07:53 AM](#)

Commissioner Ridle reviewed slide 6, "FY 18 Contribution Rates - PERS":

Defined Benefit

Employee:

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

Employer:

- 22% Cost Share

State:

- 3.01% Additional State Contribution

Defined Contribution

Employee:

- 8% All Employees

Employer:

- 5% Investment Account
- 1.03% Health Care
- 0.43% Occupational Death & Disability
- Peace Officer/Firefighter
- 0.16% Occupational Death & Disability - All Others
- HRA - flat dollar, 3% of all PERS/TRS average annual compensation

Senator Micciche noted that there was a differential between peace officers and fire fighters and all other

employees. He asked if the differential had been deemed constitutional or if it had been challenged in any way.

Commissioner Ridle did not think that the differential had been challenged.

Senator von Imhof referenced slide 5 and asked if the department tracked whether retirees lived in Alaska or elsewhere.

Commissioner Ridle answered in the affirmative and noted that retirees could sign up for the Cost of Living Allowance (COLA) if they lived in-state, which the department tracked.

Senator von Imhof asked if the department had run a comparison to see if the individuals that received COLA had also received a Permanent Fund Dividend (PFD).

Commissioner Ridle answered in the affirmative, and stated that there was about 2,000 people that received COLA but did not get the PFD. The commissioner had directed the division to reach out to the individuals to double check that they understood the COLA rules. She noted that there were further tools that the department would utilize in the near future.

Senator von Imhof hoped that the committee would see a report with clarification in terms of residency requirements and proof of residency for individuals that received COLA. She hoped that process was as rigorous as that of PFD eligibility.

[9:12:12 AM](#)

Commissioner Ridle showed slide 7, "Teachers' Retirement System."

Commissioner Ridle reviewed slide 8, "Chronology - TRS":

- 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 Ridle spoke to slide 9, "Membership - TRS (as of 12/31/2017)":

- 57 Member Employers

- 2 Defined Benefit (DB) Tiers
 - 12,998 retirees
 - 709 terminated members entitled to future benefits
 - 4,882 actives (47%)
 - 18,589 total DB members

- 1 Defined Contribution (DC) Tier
 - 9 retirees
 - 441 terminated members entitled to future benefits
 - 5,550 actives (53%)
 - 6,000 total DC members

SOURCE: Division of Retirement and Benefits.
Membership Statistics as of 12/31/2017

Commissioner Ridle reiterated that the number of retirees listed on the slide included dependents.

Commissioner Ridle showed slide 10, "FY 18 Contribution Rates - TRS":

Defined Benefit

Employee:

- 8.65% All Employees

Employer:

- 12.56% Cost Share

State:

- 14.22% Additional State Contribution

Defined Contribution

Employee:

- 8% All Employees

Employer:

- 7% Investment Account
- 0.91% Health Care
- 0.00% Occupational Death & Disability
-

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

Commissioner Ridle pointed out that under the Defined Contribution plan, employers did not pay for occupational death and disability, but did pay for the Health Reimbursement Account (HRA).

Co-Chair MacKinnon referenced slide 10 and asked if the additional state contribution of 14.22 percent (under defined benefit) was above the employer cost share. She wondered if the amount was capped in statute.

Commissioner Ridle stated that the employer would pay 12.56 percent, and the state paid an addition 14.22 percent to fill the unfunded liability.

Co-Chair MacKinnon asked if the amount was capped in state statute.

AJAY DESAI, DIRECTOR, DIVISION OF RETIREMENT AND BENEFITS, DEPARTMENT OF ADMINISTRATION, informed that the 12.56 percent was capped for the Teacher's Retirement System (TRS), and the 14.22 was state assistance based on evaluation of 2018.

Co-Chair MacKinnon observed that the number went up and down for the state. She stated that the state was picking up the difference based on what actuaries reported was needed to make up the difference in unfunded liability.

Mr. Desai answered in the affirmative.

Senator von Imhof thought the number was significant. She wondered if there was a graph to show how the number had fluctuated over time, and what the contributing factors were. She wondered about a projection of the figure over the next three to five years. She thought the matter needed to be better understood and managed to the degree it was possible.

Commissioner Ridle thought there were upcoming slides that would address the matter.

[9:15:56 AM](#)

Commissioner Ridle reviewed slide 12," Balance Sheet - PERS / TRS (in thousands)," which was the balance sheet for the years 2016 and 2017. She made note of the word "draft" next

to the 2017 column and noted that the figures would not be finalized until the meeting of the ARM board in June 2018. She pointed out that the funding ratio for the Public Employees' Retirement System (PERS) Defined Benefit program had stayed close to the same between the two years. The same was true for the TRS Defined Benefit.

Commissioner Ridle addressed Senator von Imhof's question and noted that there had been some unexpected occurrences. Salary increases, medical, and retirement had been lower than expected. Additionally, the department had updated retiree dependents to remove duplicates and other inaccuracies. Additionally, there had been a smaller than expected post-retirement pension adjustment. There had been higher costs for pharmacy, and fewer terminations in the system than previously assumed; both of which did not work in the state's favor. All the factors were considered in the actuarial analysis.

Co-Chair MacKinnon referenced the unfunded liability, which hovered just above \$6 billion between the two systems. She understood that the administration had short-funded the amount due to the retirement system and asked if there was a slide to address the matter. She asked if the commissioner could provide feedback.

Commissioner Ridle wondered if Co-Chair MacKinnon was referring to the \$1 million Employer Group Wavier Program (EGWP) contribution that had been placed in the budget. She stated that the department would apply the EGWP to the pharmacy program, which would take a year to implement. The new program would reimburse retirees as they used the pharmacy program rather than after the use of the drugs. The department expected to have a \$25.1 million reimbursement the following year for drugs.

Co-Chair MacKinnon asked if the ARM board supported the administration in the process. She thought accounting for savings before it was realized could cause concern.

Commissioner Ridle stated that the ARM board had passed a resolution to support the EGWP. She thought the ARM board had taken a vote to accept the process.

[9:20:36 AM](#)

Co-Chair MacKinnon asked if the ARM board supported short-funding.

Commissioner Ridle stated that the ARM board supported the idea that the state would get the funds as time passed, get reimbursed, and use the funds right away.

Senator Micciche thought it would be helpful to see a chart of funding ratio differences of the unfunded liability for the last ten years.

Commissioner Ridle advanced to and reviewed slide 19, "PERS Funding Ratio History (Based on Valuation Assets)," which showed a bar graph depicting the funding ratio over time from 1979. She noted that slide 20, "TRS Funding Ratio History (Based on Valuation Assets)," showed the funding ratio history for TRS.

[Commissioner Ridle returned to slide 12]

Co-Chair MacKinnon asked if there were new assumptions that were being considered that would change the funding ratio downward. She recalled that there were new criteria being adopted for mortality rates. She discussed changes in the funding ratio and was concerned since all of the numbers transferred to local communities.

Commissioner Ridle stated that the board had been going through an experience study and would vote in an upcoming meeting on the expected rate of return. The rate had been about 8 percent for about 11 years, but with the experience study new information would be considered.

Co-Chair MacKinnon asked when the ARM board would vote on the matter.

Commissioner Ridle thought the vote would be in June 2018.

Co-Chair MacKinnon asked if the legislature could expect to see a supplemental request if the rate was reduced.

Commissioner Ridle answered in the affirmative.

Co-Chair MacKinnon expressed concern.

[9:24:06 AM](#)

Senator von Imhof referenced slide 24, which she thought was compelling. She discussed the importance of cash flow and wondered about the cash flow needs for the next five years based on actuarial inputs. She thought a supplemental request was a complete surprise that would affect all the other departments. She asked the commissioner to estimate a range of future payments based on assumptions.

Mr. Desai stated when the actuarial evaluation fluctuated for any reason, it did not have an immediate impact, but rather in a future valuation process. He addressed the question of under-funding. He discussed the Retention and Disposition Schedule (RDS) project, through which the department got a retirement drug subsidy. He explained that EGWP worked in reverse, and if the state enrolled, it allowed for discounted drugs instead of subsidies, so savings were realized up front. State law allowed for appreciation of funds into future liability, compared to RDS, which did not.

Co-Chair MacKinnon understood, and clarified that the change in assumptions and in the rate of return would necessitate a supplemental.

Commissioner Ridle had been mistaken and corrected that the savings was worked into future valuations and the department did not necessarily submit a supplemental budget request.

Co-Chair MacKinnon asked if the state would see an increase in the request in FY 20 to reflect the changes.

Mr. Desai answered in the affirmative.

Co-Chair MacKinnon asked if the numbers were available to share.

Commissioner Ridle answered in the negative.

Co-Chair MacKinnon explained that the unknown increase in spending was seen as a supplemental.

[9:28:28 AM](#)

Vice-Chair Bishop commented that the subject could be a policy discussion with the administration. He discussed working from assumptions versus estimating.

Co-Chair MacKinnon stated that the committee was concerned with the fiscal situation of the state. She knew that in the background was a \$6 billion plus unfunded liability and was thankful it already reflected health costs. Other states had unfunded liabilities that were much greater. She referenced Vice-Chair Bishop's remarks and expressed concern about the unfunded pension liability. She thought that several members of the committee felt similarly.

Commissioner Ridle did not disagree.

Commissioner Ridle discussed slide 13, "ARM Board Long - Term Returns," which showed a table of ARMB Long Term Returns through June 30, 2017. She reminded that the ARM board would be considering the return rate in June 2018. The slide showed long term returns from the first year through 33 years, along with the averages.

Commissioner Ridle turned to slide 14, "Benefit Formula":

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.

Commissioner Ridle stated that the slide was intended to show how contributions combined with investment earnings should equal benefits and expenses, if actuarial assumptions were accurate. She reminded that any of the dozens of assumptions could change the outcome.

Senator von Imhof referenced the State of Wisconsin, which was solvent. The state had made larger payments in higher earning years and had established a floor for years when returns were not good. She thought the arrangement had worked over time and had acted to decrease the unfunded liability. She did not know if it was possible to utilize the same technique in Alaska. She thought there were other states that had successfully addressed benefit plans through the same technique. She wondered if Alaska could attempt the same structure.

Commissioner Ridle understood that it was not possible to return to the tiers because of a constitutional diminishment issue.

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Co-Chair MacKinnon thought the Alaska Supreme Court had ruled on the matter of diminishment of retirement plans. It was found that benefits were guaranteed. Alaska would have to do a constitutional amendment to address the court ruling.

Senator von Imhof considered that it was possible, only difficult.

Co-Chair MacKinnon thought that if a constitutional amendment came to the legislature or during a constitutional convention to address benefits, it could go before the people of Alaska for consideration.

Senator Stevens commented that on behalf TRS retirees, he appreciated the constitution and the courts.

Co-Chair MacKinnon thought all retirees were thankful that benefits were protected. She shared her concern that if the state couldn't make the payments, the system could collapse. She suggested that many members of the committee had been working to solve the problem. She discussed the concept of managing current benefits with retiree benefits.

Co-Chair MacKinnon referenced slide 14, and asked if there would be less of a liability if revenues were greater. She relayed that there had been conversation that the administration had been conservative with its projections on revenue.

Commissioner Ridle answered in the affirmative.

Commissioner Ridle displayed slide 15, "Additional State Contributions - PERS / TRS," which showed a table of of historical state contributions to PERS and TRS. She pointed out that the current year's contribution of \$135.2 million for PERS and \$128.1 for TRS before the EGWP reduction.

Commissioner Ridle moved to slide 16, "Unfunded Liability - PERS / TRS," which showed a bar graph that depicted the unfunded liability over time.

Commissioner Ridle showed slide 17, "Funding Ratio - PERS / TRS," which showed a table that depicted the funding ratios starting in 2015. She noted that the table was continued on the next slide.

Commissioner Ridle spoke to slide 18, "UPDATED Funding Ratio - PERS / TRS DRAFT2017 Results," which showed the data table from the previous slide, updated for 2017. She reiterated that the 2017 numbers were in draft form until they were voted upon at the ARM Board meeting in June 2018. She pointed out that the funding ratios remained fairly similar across the table.

Co-Chair MacKinnon pointed out that the amounts on the slide were affected greatly by the \$3 billion cash infusion in FY 15 to the TRS and PERS system put forth by the legislature, in collaboration with the governor.

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Commissioner Ridle explained that slide 19, "PERS Funding Ratio History (Based on Valuation Assets)," and slide 20, "TRS Funding Ratio History (Based on Valuation Assets)," both showed bar graphs depicting funding ratios over time.

Vice-Chair Bishop considered slide 20 and noted that the years of 1996 through 2001 showed over-funding.

MIKE BARNHILL, DEPUTY COMMISSIONER, DEPARTMENT OF REVENUE, addressed the chart on slide 20, which reflected the percentage funded ratio shown in the actuarial evaluations each year since 1979. He recalled that there was a period of time in which the actuary used a set of assumptions that were not grounded in reality, which was reflected in the periods of over-funding. In 2002, there was an actuarial audit requested by DOA, which showed that there had been actuarial practices that had been inappropriate, particularly with respect to the projection of healthcare costs. As a result of the audit, the actuarial valuation for 2002 reflected the emergence of a substantial unfunded liability. At that time, the unfunded liability had been approximately \$4 billion.

Mr. Barnhill continued to discuss Vice-Chair Bishop's question. He noted that in the wake of the audit and resetting of the funded ratios, the legislature looked at

ways to address the under-funding, which had culminated in the passage of legislation in 2005 which closed the defined benefit system to new employees. He thought one way of looking at the chart was to recognize that actuaries at the time thought the system was overfunded, but in reality the funding had been overstated through actuarial negligence.

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Vice-Chair Bishop asked if the legislature was making any deposits into the fund during the time frame being discussed.

Mr. Barnhill showed slide 21, "PERS Contribution Rates," which showed a line graph spanning the years 2000 to 2019. He noted that prior to 2007, the system was primarily employer and employer-contribution funded. The state did not begin making contributions separate and apart from its status as an employer until 2007.

Vice-Chair Bishop emphasized that a defined benefit plan would work if it was honest with the multiplier in the actuarial assumptions.

Mr. Barnhill thought it was possible to discuss the subject at length. He thought that defined benefit systems were infinitely sustainable if the payments were maintained, and if the actuarial computations were continually checked for fairness. He discussed the employment structure and audit of actuaries to ensure things were being done correctly each year.

Senator von Imhof referenced Mr. Barnhill's statement about plans working if payments were made. She thought that there many assumptions in the statement. She considered that the plans had a hard time working when there were costs and market fluctuations beyond the state's control. She thought that simply "making the payments" crowded out other state expenditures such as public safety and education.

Mr. Barnhill did not intend to be cavalier. He affirmed that Senator von Imhof's remarks were correct, and there was a variety of things that had to happen. He thought there were many factors to intervene to make the sustainment difficult. He thought that the legislature had been incredible in supporting the system through additional state assistance payment. He thought it was not reflected

in the experience of most other states. He considered the state of Kentucky, that had a funded ratio of close to 18 percent and was close to imploding. He did not want to diminish the substantial challenge in the state of Alaska.

Mr. Barnhill thought there was a variety of tools that the legislature and administration had engaged to balance expenditure concerns in a fair way. He referenced the \$3 billion cash infusion (by the extension of amortization of the liability by 9 or 10 years) to manage state assistance payments in the short term and balance competing needs.

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Co-Chair MacKinnon acknowledged that the topic was important to all.

Senator Micciche did not want to overstate the position the state was in with unfunded liability. He understood Mr. Barnhill's comments. He thought the state had realized after 2002 that the legislature had not prioritized the systems in the time of greatest revenue. He discussed fluctuating state revenue and thought in higher revenue years the state would need to keep the systems as a priority and consider additional cash infusions.

Co-Chair MacKinnon asked if past higher revenue years were the same years the state was in a lawsuit with the actuaries. She wondered if legislators had not made payments in higher revenue years because the actuaries were producing a lower number for liability.

Mr. Barnhill had neglected to mention that in addition to the declining funding ratios in 2002 to 2007; the state had filed a lawsuit against its actuaries for actuarial negligence, which had been settled in 2010. There had been additional action taken in the state's interests to seek recovery. The state asserted that from 1994 to 2000 the actuary was acting negligently, which formed the basis for the lawsuit.

Co-Chair MacKinnon thought Vice-Chair Bishop had pointed out that there were reduced payment requests at a time when higher payments should have been made.

Mr. Barnhill answered in the affirmative. He explained that actuaries used past experience to look forward in time to

determine what employers should contribute on a year over year basis. The employer contribution rates set during the period in question had been inappropriately low. Had the actuaries been using best practices, the employer contribution rates would have been substantially higher. The lawsuit had tried to articulate the theory that the state had not been allowed the opportunity to contribute in an appropriate way because the issues in the system were not transparent because of the inappropriate projection of healthcare costs.

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Mr. Barnhill made the distinction that the lawsuit did not bear on the state contributing additional money (such as through state assistance); but rather bore on what employers contributed through the employer contribution rate. The state was the biggest employer and had an issue with PERS during the time reflected on slide 21.

Senator Micciche thought that after the state settled the lawsuit it experienced high revenue years. He thought changes to retirement benefits in the constitution was a difficult topic to consider. He thought the system could be properly maintained to avoid disaster.

Vice-Chair Bishop thought it would be interesting to see a slide that considered the funding ratio if there had been an additional \$1 billion deposit. He thought some legislators had pushed for a bigger cash infusion towards the unfunded liability. He wondered how many states would like to be at 82 percent funding for pension systems.

Mr. Barnhill thought all states would like to be funded at 82 percent with respect to health plans. He stated that Alaska's health funded ratio was close to 100 percent. He referenced slide 18 and thought there were no other states funding at the same level as Alaska. Most defined benefit health plans were started with the assumption that the benefits would be paid on a pay-as-you-go basis; rather than the notion of saving in advance. He thought that the fully-funded nature of the state's health program was due to the wisdom of the legislature and the executive branch in taking responsibility for funding the programs in advance. He addressed the funded status of the pension side, and thought the state was doing ok. He thought that anything funded at less than 80 percent on an open plan

could use improvement. He thought it was essential to keep working to make sure the programs were administered and funded properly.

[9:56:27 AM](#)

Senator Micciche referenced the \$3 billion cash infusion to PERS and TRS. He asked if the funds were deposited into the area of the state's liability with the greatest financial value.

Mr. Barnhill stated that the intention was for 100 percent of the appropriation was to go into the pension portion of the unfunded liability. The relative funded ratio between pension and health and PERS and TRS was different. The health funded ratio had increased steadily since 2007. The state had wanted to maintain similar funded ratios for pension and health. The spread emerged between pension and health because the new actuary had introduced a level of conservatism in projecting health costs, so the state over-collected from 2008 to 2014. When the funds came in, the actuaries did another calculation, and believed to maintain parity, additional funds needed to be added to the health part of TRS.

Mr. Barnhill continued that subsequent to approving the \$233 million (of the \$2 billion deposit to TRS), the actuary had considered additional information: in January of 2014 the state transitioned to Aetna and had a more advantageous network resulting in lower claims costs. There had been substantial savings which the actuary considered, as well as a health care assumption change made by the ARM board. The two considerations offset the actuary's mid-year determination of where the \$2 billion should be placed. At the close of FY 15, the funded status in the TRS health plan was approaching 100 percent, which had not been the objective. Had the \$233 million been moved into pension as originally planned, the funded ratio in TRS would not have gone up as much. He believed that over time the matter would work itself out.

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Senator von Imhof thought it would be useful if the chart on slide 15 could be extrapolated to include the years 2019 through 2023 in order to plan future cash flow. She referenced charts on slide 21 and 22, which showed employer

contribution rates in blue and the state subsidized amount above. She asked if there were unintended consequences. She used the hypothetical scenario of closing a library in Cordova. She understood that if any municipality eliminated a job classification, there would be consequences and a report would be required to show the impact to PERS and TRS contributions. She thought the potential lack of contribution sometimes exceeded the impact of just keeping the position filled.

Co-Chair MacKinnon asked if Senator von Imhof was speaking about a termination study.

Senator von Imhof answered in the affirmative. She thought that there was a disincentive for communities to contract during difficult economic times.

Mr. Barnhill stated that the issue of termination studies had been a perennial issue since statute was amended to explicitly require termination studies. He thought there was a balance of concerns, triggered by the fact that the terminated group and its accrued constitutional benefits. He considered how to account for the benefits appropriately, so the system was not shorted by the individuals exiting the system early. He thought there was a provision in law that employees in a terminated class could vest automatically. When one vested automatically in benefits, there was an immediate unplanned liability to the system that needed to be resolved.

Mr. Barnhill asserted that the department understood the issue as discussed by Senator von Imhof. He stated that the administration had worked over the years to try and craft a solution. He thought there was a desire and willingness to find a fair and balanced solution.

[10:05:18 AM](#)

Co-Chair MacKinnon asked if it was fair to say that municipalities would like to cost shift the liabilities to the legislature.

Mr. Barnhill thought that it was important to recognize that in the administration of any defined benefit system there were multiple stakeholders that had interests that were not completely aligned.

Co-Chair MacKinnon expressed understanding of Mr. Barnhill's answer. She thought the state had balanced the needs of municipalities requesting termination studies over time. She discussed the 22 percent cap on municipalities' contribution.

Senator Micciche recalled struggling with termination studies as the mayor of a small town. He thought it was not mathematically possible that retaining an employee would cost less than a termination study.

Mr. Barnhill deferred the question and suggested Senator Micciche work with Commissioner Ridle to discuss the matter. He recognized and acknowledged that there were scenarios in which the math was challenged. He believed that over the years the division endeavored to administer the statutes as intended by the legislature. He referenced non-alignment of stakeholder interest and thought the state might not have the same view as municipalities.

[10:08:50 AM](#)

Senator Micciche appreciated Mr. Barnhill's frankness. He thought it would be extremely helpful for members to review a body of information on termination studies and the PERS and TRS systems, in order to understand how to administer and maintain the systems. He thought deep knowledge of the systems was confined to a small number of legislators.

Co-Chair MacKinnon referenced the remarks of Senator Stevens that said "history was important." She thought it was important to consider the history of the matter, including the 22 percent cap on contributions. She thought that if termination studies were eliminated, the state would have sole responsibility for making the system whole, which she did not think was possible considering the state's current cash flow.

Co-Chair MacKinnon referenced slide 19 and stated that the Legislative Finance Division had suggested the committee discuss assumed returns and how they affected the funding ratio. She discussed an impact on market returns in 2002. She asked for Mr. Barnhill to highlight market returns when discussing the history of TRS and PERS.

Mr. Barnhill thought one way to improve or enhance the narrative of slide 19 was to include the market investment

return at the bottom of each of the bars on the graph. He mentioned a reversal in investment markets in 2001, which had contributed to the decline in funded status. The decline had been coincident with the aforementioned actuarial negligence. He cited additional market corrections in 2008 and 2009, which further challenged funding to the system at the time.

[10:12:38 AM](#)

Co-Chair MacKinnon wondered how much of the recently rebounded stock market was propping up the 77 and 78 percent assumed returns. She discussed a time when oil prices were low and the state hadn't made payments.

Mr. Barnhill thought there were a variety of enhancements the chart on slide 19 could benefit from; such as the price of oil, which could reflect the overall capacity of the state to make additional contributions. He discussed the impact of the returns of the investment markets on the 2015 to 2016 time period. The actuarial earning assumption was 8 percent. He acknowledged that market was volatile, but there had been a long-running bull market that began after a recession in 2009. The state's investment advisors, Callan and Associates, were relatively pessimistic about the continuance of the bull market for the next 10 years and had advised the ARM board to expect an annual average return rate of 6.6 percent. The Permanent Fund Corporation had advised for an expectation of a 6.5 percent rate of return.

[10:15:58 AM](#)

Co-Chair MacKinnon discussed healthcare and referenced meetings with Mr. Barnhill and DOR Commissioner Sheldon Fisher. She asked if there were any negative consequences the state could experience because the plan was 100 percent funded. She wondered if retirees could call for more benefits. She was concerned about the possibility of increased costs for increased benefits because the system was over 100 percent funded.

Mr. Barnhill reiterated that there were various sets of stakeholders involved. He reminded that the retirees naturally desired the best health benefits the system could afford. He did not think retirees as a group would ever not be interested in better benefits. He was not aware of legal

requirements that would require enhanced benefits if a system was funded over 100 percent. He believed there was a post-retirement pension adjustment (PRPA) that was triggered whenever pension funding went over 105 percent. That state was not close to 105 percent of pension funding, so the PRPA was not a concern. He thought that as administrators (for retirees and active employees) the state wanted a health plan that was sustainable and fair, and provided security for retirees.

[10:19:06 AM](#)

Co-Chair MacKinnon wanted to protect retiree benefits, which was why the legislature had focused on the benefit portion of the payment. She shared concerned that if healthcare options were increased for retirees, it became constitutionalized and became a fixed cost for the future. She noted that the legislature had been specific about the contribution and had argued that the funds not be divided equally; since the state had a 100 percent responsibility for teachers and only 60 percent responsibility for those in the PERS/TRS system. She clarified that the state supported 100 percent payment for teachers. In the PERS system, local municipalities hired individuals in communities, and the state covered part of the expense. She wanted to ensure that when discussing the unfunded liability, people knew that it was only 60 percent state debt.

Senator Micciche was impressed with Mr. Barnhill's earlier comments. He asked what the most financially beneficial balance between healthcare and the PERS and TRS liability funding to ensure the health of the systems. He wondered if the state should make a shift for the most financially beneficial balance.

[10:22:05 AM](#)

Mr. Barnhill had contemplated a rebalance between the pension and health care silos. He noted that prior to 2007, there had only been one account in which pension and health contributions were co-mingled. Tax counsel at the time had advised disaggregating the accounts, which was achieved by passing legislation. The United States Internal Revenue Service (IRS) had allowed the state to move money from the legacy account into the new health account on a pro rata basis. He noted that the funding ratios for pension and

health were exactly the same in 2007, because that's when the parity in funding ratios policy was established.

Mr. Barnhill continued to address Senator Micciche's question. He thought the biggest issue was if the IRS would allow the state to go backwards and move funds from health care back to pension. He summarized that he felt that the \$233 million had a relatively low overall impact to the system, especially over time. He noted that there was a pending experience analysis that would consider an appropriate earnings assumption and appropriate mortality table for the systems to adopt. He recommended that although it was possible to seek permission to reallocate funds from health to pension, he would wait to see the outcome of the experience study and how it would impact the funded status of the systems.

Co-Chair MacKinnon asked for Mr. Desai to comment.

Mr. Desai thanked Mr. Barnhill for his historical perspective on the matter.

[10:26:00 AM](#)

Commissioner Ridle moved to slide 23, "Projected Retirement Population Growth," which showed a line graph. She pointed out the downward curve starting in 2027.

Commissioner Ridle discussed slide 24, "Basic Facts - PERS / TRS Benefits," which showed a graph. She agreed with Senator von Imhof that the slide could have been shown earlier in the presentation. The graph showed what payments were expected to be over the next 70 years. The slide also showed the PERS/TERS account balance and the unfunded liability amount.

Senator Micciche asked to return to slide 13. He asked if there was a way to average or smooth the average in the actuarial analysis.

Mr. Desai indicated that the slide showed actual rate of returns. For the actuarial purposes, the numbers were smoothed out based on 5-year averages. He stated that his next presentation would show the trend of the actual returns versus valuation returns compared to the funding ratio.

Co-Chair MacKinnon stated that in the past, the committee had been able to see how the ARM board was investing and had seen further information on asset allocation. She referenced slide 19, and the volatility of oil revenue. She asked if the department could provide further information.

Commissioner Ridle answered in the affirmative.

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

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ADJOURNMENT

[10:29:46 AM](#)

The meeting was adjourned at 10:29 a.m.