

HOUSE FINANCE COMMITTEE
April 15, 2019
1:30 p.m.

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CALL TO ORDER

Co-Chair Wilson called the House Finance Committee meeting to order at 1:30 p.m.

MEMBERS PRESENT

Representative Neal Foster, Co-Chair
Representative Tammie Wilson, Co-Chair
Representative Jennifer Johnston, Vice-Chair
Representative Dan Ortiz, Vice-Chair
Representative Ben Carpenter
Representative Andy Josephson
Representative Gary Knopp
Representative Bart LeBon
Representative Kelly Merrick
Representative Colleen Sullivan-Leonard
Representative Cathy Tilton

MEMBERS ABSENT

None

ALSO PRESENT

John Scanlon, Staff, Representative Jonathan Kreiss-Tomkins; Ajay Desai, Director, Division of Retirement and Benefits, Department of Administration; Kathy Lea, Deputy Director, Division of Retirement and Benefits, Department of Administration; Kevin Worley, Chief Financial Officer, Department of Administration.

PRESENT VIA TELECONFERENCE

Chris Rose, Executive Director, Renewable Energy Alaska Project; Stacy Barnes, Director, Governmental Relations and Public Affairs, Alaska Housing Finance Corporation; Eric Havelock, Lending Officer, Mortgage Operations, Alaska Housing Finance Corporation.

SUMMARY

HB 32 AK ENERGY EFFICIENCY LOANS: ELIGIBILITY

HB 32 was HEARD and HELD in committee for further consideration.

PRESENTATION: PERS/TRS SYSTEM

#hb32

HOUSE BILL NO. 32

"An Act making certain entities that are exempt from federal taxation under 26 U.S.C. 501(c)(3), (4), (6), (12), or (19) (Internal Revenue Code), regional housing authorities, and federally recognized tribes eligible for a loan from the Alaska energy efficiency revolving loan fund; relating to loans from the Alaska energy efficiency revolving loan fund; and relating to the annual report published by the Alaska Housing Finance Corporation."

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Co-Chair Wilson shared that the bill had been heard in the past.

JOHN SCANLON, STAFF, REPRESENTATIVE JONATHAN KREISS-TOMKINS, relayed that the bill had been heard by two legislatures previously. He read from a prepared statement:

Many of you might be familiar with HB 32. This is the third legislature that the bill has seen. During the 30th Legislature, this bill passed all committees of referrals in the House and died in House Rules. During the most recent legislature, the 31st, this bill passed all committees in the House, passed out of the House of Representatives 35 to 1 in identical form as to what you have before you, then moved over to the Senate and died in its last committee of referral there.

So, the bill is back.

House Bill 32 relates to the Alaska Energy Efficiency Revolving Loan Program, or the AEERLP for short, which is a bond authorized revolving loan program.

Presently, the only eligible entities that can apply for energy efficiency loans from the AEERLP are public entities, such as municipalities, school districts, state buildings, and the University of Alaska. House Bill 32 broadens eligibility to include nonprofits, federally recognized tribes, and regional housing authorities as entities that can apply for energy efficiency loans through the AEERLP.

Under House Bill 32, churches, arts councils, regional housing authorities, chambers of commerce, your neighborhood VFW post, soup kitchens - you name it - would be allowed to apply for an energy efficiency loan through the AEERLP in order to finance energy efficiency improvements, and these improvements can enable nonprofits to save on their energy costs.

Often these kinds of nonprofit organizations have energy inefficient buildings and are relatively cash poor - meaning they don't have a lot of ability to make upfront capital investments, even if there's a great return on those upfront capital investments. That's where we believe this loan program can be valuable.

What's unique about the AEERLP is that in order to apply for the loan, one must first obtain an Investment Grade Energy Audit. This audit identifies which energy efficiency improvements could be made and how much money would be saved as a result. The guaranteed savings from the energy efficiency improvements, which are identified by the Investment Grade Audit, are used to repay the loan.

The AEERLP is administered by the Alaska Housing Finance Corporation, also known as AHFC, and was created by the legislature in 2010 through the Alaska Sustainable Energy Act. At that time, in 2010, the legislature granted AHFC the authority to bond up to \$250 million to finance energy efficiency loans - a sum which, if utilized, could save Alaskans a significant amount on energy costs.

Unfortunately, this program has been deeply underutilized.

Since 2010, AHFC has received only three applications from public entities for these energy efficiency loans and closed only one loan through this program - for \$2.5 million to the City of Galena. According to AHFC, who is on the line and can speak to this or any other question, one applicant found alternative capital, while the other used their Investment Grade Audit to create a three-year capital improvement program for energy efficiency upgrades using existing maintenance staff.

Again, to be clear, there's not just a pot of \$250 million sitting around, but this authority that AHFC has to bond up to \$250 million to finance energy efficiency loans for Alaskans is a powerful existing resource that's been untapped.

Moreover, to the best of our knowledge, the AEERLP offers the only dedicated energy efficiency loan in Alaska, and we are not aware of an analogous loan program from a private lender. The AEERLP fulfills a distinct purpose.

In closing, Rep. Kreiss-Tomkins originally introduced this bill when the state began to run budget deficits - in his words, "when the gravy train was ending" - and some of his thinking was instead of nonprofits having their problems partly solved through free money by way of capital appropriation, this could be another tool in the toolbox for nonprofits to be self-sufficient in tackling their own problems, so they can continue to serve such important roles in our communities.

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Co-Chair Wilson noted a representative from Alaska Housing Finance Corporation (AHFC) was available online for questions. She appreciated Mr. Scanlon's testimony informing the committee there was not \$250 million sitting around.

Co-Chair Wilson OPENED public testimony.

CHRIS ROSE, EXECUTIVE DIRECTOR, RENEWABLE ENERGY ALASKA PROJECT (via teleconference), spoke in support of the legislation on behalf of the Renewable Energy Alaska

Project (REAP). He detailed that REAP was a nonprofit comprised of nearly 80 businesses including electric utilities, Native corporations, and non-governmental organizations. The organization's mission was to increase the development of renewable energy and increase energy efficiencies throughout the state. He shared that REAP had supported the passage of SB 320 in 2010, which had created the AEERLP [Alaska Energy Efficiency Revolving Loan Program]. The organization believed energy efficiency was the top priority, particularly for buildings. He reported that approximately 40 percent of all energy used in the country was used in buildings. He informed the committee that unfortunately, many of the buildings in Alaska needed to be energy retrofitted.

Mr. Rose highlighted that when including all energy consumed by Alaskans, the cost was approximately \$5 billion per year. The figure included transportation and electricity, but a large portion went to heating buildings. He explained that if even a sliver of the expenditures could be saved it would mean much more money in the state's economy. He brought attention to a successful program administered by AHFC that conducted residential retrofits. The legislature had appropriated over \$600 million over the course of a decade for energy retrofits in 50,000 individual households. The average had been about \$10,000 per household, although many households had put more money in. The average energy bill savings from the residential retrofits was about 30 percent. He reported AHFC's estimate that the 50,000 homes were collectively saving about 25 million gallons of heating oil equivalent annually.

Mr. Rose explained that buildings could successfully save money on their energy bills if they took on the kinds of retrofits that HB 32 would allow. He underscored REAP's strong support for the bill. He explained the bill would be another tool in the toolbox for nonprofits and tribes to borrow money where they may not be able to gain access to low cost or decent interest rates. The loans would allow borrowers to save more money monthly on their energy bills than they were paying back. The organization believed in the excellence of the program and strongly supported the bill.

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Representative LeBon referred to the AHFC Home Mortgage Energy Loan Program. He asked if AHFC recorded a lien against a property under the program.

Mr. Rose clarified that he had been referring to the weatherization grant program administered by AHFC and an energy rebate program. He did not believe any kind of lien was set against the home in either program.

Representative LeBon asked if a lien would be recorded against a property under the program in the bill.

Mr. Rose was uncertain. He noted that someone from AHFC would be able to answer the question.

Co-Chair Wilson informed committee members that AHFC was available to answer questions following public testimony.

Co-Chair Wilson CLOSED public testimony.

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STACY BARNES, DIRECTOR, GOVERNMENTAL RELATIONS AND PUBLIC AFFAIRS, ALASKA HOUSING FINANCE CORPORATION (via teleconference), introduced herself and stated her understanding of the question.

Representative LeBon agreed.

Ms. Barnes replied that AHFC may record a lien. She reported that the agency had not recorded a lien on the one project that closed in Galena because of the other collateral available on the loan.

Representative LeBon asked if AHFC needed to be in a senior position or would be willing to take a junior position if a lien was recorded.

Ms. Barnes answered it would depend on the risk associated with the loan and the loan size. She detailed that any loans over \$1 million required approval by the AHFC board of directors, which took a number of factors into consideration.

Representative LeBon asked if AHFC required an appraisal on a property being approved with the energy efficiency.

Ms. Barnes answered that an appraisal was not required; however, an energy audit was required prior to work taking place and prior to a financing commitment.

Representative LeBon asked for verification that AHFC's interest in the collateral was about energy efficiency and not related a loan to value.

Ms. Barnes deferred the question to a colleague.

Representative LeBon elaborated that his question pertained collateral positions; first, second, or junior liens; collateral valuation, and traditional real estate lending. He asked if AHFC would look at the loan as collateralized or unsecured credit.

ERIC HAVELOCK, LENDING OFFICER, MORTGAGE OPERATIONS, ALASKA HOUSING FINANCE CORPORATION (via teleconference), replied that it was a hybrid of what Representative LeBon was referring to as conventional real estate financing. The corporation looked for a form of collateral that was acceptable to its board. He detailed it could be either conventional collateral (e.g. a deed of trust secured against real estate) or an assignment of a revenue stream.

Representative LeBon noted that AHFC would record a lien position if it was conventional collateral in the form of real estate on the property being improved. He asked if AHFC had developed a policy identifying what the lien position needed to be, what loan to value needed to be achieved, and whether the value of the collateral needed to be formalized.

Mr. Havelock answered that AHFC had not yet developed internal procedures as HB 32 was a bill in progress. He informed the committee that it was in AHFC's best interest to look for some form of collateral.

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Representative LeBon stated there had been a reference made earlier that the private sector was not interested in "these types" of loans or improvements. He asked if he had heard correctly.

Mr. Havelock responded that to AHFC's knowledge there was not an analogous loan program currently offered by the

private sector. He could not speak to whether the private sector was interested in offering one or not.

Representative LeBon replied that the private sector was willing to make the loans. He had made a number of the loans in his past banking career. He reported that banks looked for value of collateral, loan to values, repayment ability, lien positions, and capacity to repay. He remarked that if those issues (that were common in the private sector) had not been thought out, the program [addressed by the legislation] was not fully developed.

Co-Chair Wilson noted it was her understanding that the program had not been used because many entities had found a better way to finance their program. She asked if the statement was accurate.

Mr. Scanlon replied it was his understanding based on information from AHFC.

Co-Chair Wilson asked if the program was taking business away from banks.

Mr. Scanlon deferred the question to AHFC. The sponsor's understanding was that it was the only dedicated energy efficiency loan program that calculated the repayment based on guaranteed savings. He noted that AHFC could also speak to interest rates. He did not believe the bill would take anything from private lending institutions.

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Co-Chair Wilson noted that the backup materials for the bill showed that one reason the program had been underutilized was that after entities had made energy efficiencies, they had gone somewhere else for the money. She was trying to determine why the nonprofits would not go to the institutions. She asked what AHFC offered that institutions did not.

Ms. Barnes emphasized that AHFC did not view itself as a competitor to private institutions. She informed the committee that banks, credit unions, and mortgage companies were partners with AHFC in providing home loans to Alaskans. There had been other capital available for public facilities in Alaska at a reduced interest rate. Under the proposed AEERLP program, there was no subsidized interest

rate to those who may come to AHFC for a loan. In 2015, the corporation's research and rural development/energy department had surveyed a number of facility owners across the state. She detailed that 33 percent of the respondents reported using cash on hand to make energy efficiency improvements, 29 percent used bonds, and 22 percent used grants.

Vice-Chair Ortiz spoke to the question about taking business away from private enterprise. He noted that with other state revolving loan programs, before an applicant could take out a revolving loan, they had to produce a denial letter from a commercial bank. He asked if the same would be true under the bill.

Mr. Scanlon deferred the question to AHFC.

Ms. Barnes answered that no denial would be required by AHFC. She added that the project would have to stand on its own merit in order for AHFC to approve the loan.

Representative LeBon considered loan approval and asked if AHFC made loans on a direct basis or if it looked to banks to underwrite the loan and submit it for approval.

Ms. Barnes replied that AHFC would directly do the loan under the specific program in HB 32.

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Representative Carpenter asked what the program enabled that could not be done through the private sector.

Mr. Scanlon spoke to the unique aspects of the AEERLP. He detailed there were two steps: 1) securing the investment and 2) AHFC developed a loan repayment schedule based on the guaranteed savings instead of the upfront capital costs. The loan repayment schedule for dedicated energy efficiency loans was unique.

Co-Chair Wilson asked for verification that the program would make the option available to entities that could not currently get a loan.

Mr. Scanlon answered in the affirmative. At present, only public entities had access to the loan; the bill would expand to nonprofits, regional housing authorities, and

federally recognized tribes. He detailed that in past years capital appropriations may have been available [which were no longer available]. The program would provide another tool in the toolbox for those entities to become more self-sustaining.

Representative LeBon followed up on the repayment program. He asked if the payment amount was predicated on establishing savings through energy efficiency improvements, whether the interest rate would be fixed for the life of the loan. He asked if the term of repayment was backed into based on the maximum payment amount if it was all predicated on how much was saved on the energy. He supposed an entity could end up with a 15 or 20-year repayment period.

Mr. Havelock answered the interest rate was set based on the term of the loan; the longer the loan term, the interest rate was slightly higher. The amount of the term was tied to the projected recapture of the energy savings. Under the current program (there were not guidelines for the bill yet), there was a 1.2 debt coverage on the savings, which meant the cash flow from the energy savings must exceed the debt payment by at least 20 percent.

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Vice-Chair Ortiz remarked that one of the selling points of the bill was that it would result in greater utilization of a fund that was currently underutilized. He asked if there had been an analysis done on what kind of response would result from the broadening of the marketplace.

Mr. Scanlon replied that anecdotally Representative Kreiss-Tomkins had a number of conversations with would-be eligible entities in his district and across the state that had expressed interest in pursuing the loans. He relayed that Representative Kreiss-Tomkins and AHFC had done a great deal of outreach to the presently eligible public entities. He reported that there had only been three applicants after nine years. He reiterated that anecdotally organizations were interested in looking into the loans to determine whether they were the right fit.

Co-Chair Wilson asked AHFC to address the fiscal note.

Ms. Barnes relayed the department had submitted a zero fiscal note for the bill [OMB Component Number 110]. She reviewed the note with a prepared statement:

The primary function of our organization is to invest in home mortgages for Alaskans. Under federal law, housing finance agencies like ours are uniquely positioned to use the tax-exempt bond market, and Alaska is one of just five states with the ability to offer qualified veterans mortgage loans. The operations of our agency are supported by the income from our investments, we are a non-general fund agency, and the debts of the corporation are not the debts of the State of Alaska. Our bonds are currently rated by S&P and Fitch at AA+, and by Moody's at AA2.

Banks, credit unions and mortgage companies are our partners. They are the ones who offer home loans to eligible Alaskans.

The enabling legislation in 2010 that allowed AHFC the opportunity to go to market to finance energy efficiency improvements for public buildings was part of a larger energy omnibus bill (HB 306). At the time, the price of oil in the State of Alaska was much higher than it is today which meant that public facilities were spending more to keep their buildings warm. There was also a recognition that infrastructure was aging, and there was an opportunity to make those buildings more energy efficient. Alaska Housing had also been the recipient of state funds that would go onto create the Home Energy Rebate and expand the weatherization programs, so we had some experience with efficiency efforts.

Around the same time, Alaska Housing received federal funds under the American Recovery & Reinvestment Act stimulus package that we used to conduct detailed energy audits on 327 public facilities, including schools, maintenance facilities, libraries and more.

From our work in the residential space with Home Energy Rebate and Weatherization programs, we knew that Alaskans were saving approximately 30% in their energy consumption. Similar savings were forecast achievable in public facilities.

HB 32 expands AHFC's authority. No longer would we be supporting public facilities alone but non-profits would be eligible under future bond issuances for eligible energy efficiency improvements.

In the same way that public facilities found financing outside of Alaska Housing, non-profits may as well; hence a view that this adds a tool to the nonprofits toolbox.

We will apply the same rigor that we use on public facilities today or with our home loans to any entity seeking funding.

The interest rate for a loan under this program will not be subsidized.

There is no "fund."

The rate (on the loans) will be subject to market conditions and costs, and the risk associated with the loan for a term up to 15 years.

Borrowers will bear the cost of that risk, which is why we have submitted a zero fiscal note. If the same loan that we funded in 2016 were come to us today, the rate would be approximately 4.625 percent."

Co-Chair Wilson noted amendments to the bill were due the following day.

HB 32 was HEARD and HELD in committee for further consideration.

^PRESENTATION: PERS/TRS SYSTEM

[1:58:05 PM](#)

AJAY DESAI, DIRECTOR, DIVISION OF RETIREMENT AND BENEFITS (DRB), DEPARTMENT OF ADMINISTRATION, introduced a PowerPoint presentation titled "Public Employees' Retirement System (PERS) Teachers' Retirement System (TRS) 2019 Update" dated April 15, 2019 (copy on file). He began with an organizational chart on slide 2 showing how the Department of Revenue (DOR) and Department of Administration (DOA) worked cohesively together with the Alaska Retirement Management Board (ARMB). He detailed that

ARMB served as a trustee for the pension and retiree health trusts, the State of Alaska Supplemental Annuity Plan, and Deferred Compensation Plans as of October 1, 2005. Responsibilities were to manage and invest assets in a manner that was sufficient to meet the liabilities and pension obligations of the systems. Some of the activities included establishing investment policies, reviewing actuarial earnings assumptions, establishing asset allocations, setting contribution rates for employers, providing investment options, and monitoring performance.

Mr. Desai moved to slide 4 showing PERS chronology:

- January 1961: Established as a joint contributory Defined Benefit (DB) plan
- 1975: Retiree Health Insurance with system-paid premiums added
- July 1986: Tier II established
- July 1996: Tier III established
- July 2006: Defined Contribution (DC) Plan established
- July 2008: Cost Share with 22% employer contribution rate

Mr. Desai elaborated that any contribution beyond 22 percent was supported by state assistance in order to fund the pension systems.

Co-Chair Wilson asked why the state had not stayed with Tier I instead of moving to Tier II in 1986 and what adjustments needed to be made under Tier III. She believed committee members were more clear about why the system had been changed to Defined Contribution. She asked what the state was trying to change when it moved to Tiers II and III.

KATHY LEA, DEPUTY DIRECTOR, DIVISION OF RETIREMENT AND BENEFITS, DEPARTMENT OF ADMINISTRATION, explained that Tier II had been established on July 1, 1986 to implement numerous cost containment measures because the liability had been growing with the Tier I benefits. Under Tier II the retirement age for normal retirement had been moved from age 55 to age 60. Additionally, the receipt of the Alaska cost of living allowance (10 percent of a person's retirement and benefit if they remained living in Alaska) had changed to age 60 instead of right at retirement. She expounded that a person could receive the cost of living

allowance if they had an early retirement under Tier I, but not under Tier II. The medical eligibility had been changed to age 60 or with 20 years of service or 30 years of service for an "all other" person.

Ms. Lea relayed the changes resulting in Tier II were supposed to have solved all of the funding issues associated with the plan; however, 10 years later, Tier III had been established to implement more cost-containment measures. She detailed that Tier III added a premium payment to the medical plan for early retirement. Additionally, there had been a geographic differential payment change. She explained that Tier I employees living in an area with a geographic salary differential were able to use the differential immediately in the calculation of their retirement benefit. One of the cost-containment measures in Tier III required a person to serve half of their service time in an area with a differential in order to use it. The implementation of Tiers II and III were made in order to contain costs of the growing liability for the benefits.

Ms. Lea continued that in 2006 the Defined Benefit (DB) Plan was closed, and the Defined Contribution (DC) Plan was instituted. She explained that under a DB Plan, all of the risk fell on the employer to pay benefits. She detailed that contributions for the employee were set in statute and if the cost for the benefits increased, the employer continued to pay. Under the DC Plan, the risk fell on the employee. Employees had an investment account they could use to accrue their investment earnings. The DC Plan also had health insurance, occupational death and disability benefits, and a health reimbursement arrangement that provided some assistance paying medical premiums.

Co-Chair Wilson stated her understanding that reopening a closed system could have ramifications to the state's credit rating. She believed that one of the passes the state received was a result of the closed system that was not accruing further damage. She asked if there could be some unintended consequences for reopening closed tiers.

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Ms. Lea answered that she could not speak to the credit rating of the state. She relayed that because of the structure of a DB Plan where all of the risk and cost

resided with the employer, the DB Plans would continue to accrue a liability (as was visible in the tiers created to contain costs), which would at some point be an unfunded liability.

Representative Sullivan-Leonard stated her understanding that when the DC Plan had been established in 2006, it was a time when many employees were not staying in state government longer than eight to ten years. She explained that the idea was the plan would be portable where once an employee was vested after five years, they could take the contribution to reinvest with a new employer. She asked if any studies had been done to see if the system was working or was a challenge for state employment and recruitment.

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Ms. Lea answered that the workforce was changing as younger generations were not remaining in jobs as long as past generations. The division had kept statistics on the retention of DB and DC members since 2006; there was a slight difference in the retention between DB and DC Plans - DC retention was slightly lower. She did not believe it was possible to definitively identify the reason for the difference. She noted that the workforce was younger and was moving more. Many of the problems in recruitment and retention that were blamed on the DC Plan were actually due to lack of information provided by employers. She expounded that employees were learning about the DC Plan from their DB Plan coworkers who did not really know anything about the plan.

Ms. Lea reported that many DC Plan employees who thought they had a poor plan were quite happy with the plan after attending an introductory seminar on the plan provided by the division. She clarified it did not mean everyone was happy with the plan. She explained that it appeared the plan was better received by employees when a stronger educational effort was made by the division. The division had been working on developing marketing materials for teacher associations and a pilot program DRB was running with the Department of Public Safety to aid in recruitment and retention by providing more robust information about the plan.

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Representative Sullivan-Leonard thanked Ms. Lea for her answer and explained she had been trying to determine whether the program was working as intended.

Representative Josephson was concerned about the enormous evidence that public safety workers/first responders were leaving the state because they did not have a DB plan. He noted that at some point there may be a legislative hearing on the topic and there would be scores of people calling in making the same argument. He thought there was some merit in the claim. Alternatively, he wondered if the division thought the individuals were all misunderstanding the beauty of the DC Plan.

Ms. Lea answered that the police/fire group was somewhat different than the "all other" group, which was the 30-year retirement group. She explained the former group was different predominantly because they had a shorter period of time to earn a retirement; therefore, their benefits were somewhat less than a 30-year employee would have. She believed there were some valid things to be looked at in the police/fire group and DRB had provided information to bill sponsors the previous session. She thought it was necessary to ask whether the return to a DB plan was the only solution to the a retirement income issue and whether the state was willing to take on that type of liability again.

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Representative Josephson referenced Ms. Lea's earlier statement that the unfunded liability would have to be realized and come to terms with. He believed that was already occurring annually. He explained the liability was amortized to about \$200 million per year. He believed there was no day of reckoning because the state reckoned with paying the liability down on an annual basis.

Ms. Lea deferred the question to a colleague.

KEVIN WORLEY, CHIEF FINANCIAL OFFICER, DEPARTMENT OF ADMINISTRATION, replied that the presentation included a slide related to the additional state contributions. He relayed that the dollar amounts under discussion were right in line. He explained that the liability "doesn't come due today" or when a valuation report was completed, but it was currently tracked through 2039. He stated that the day of

reckoning was about 20 years in the future; however, the state looked at the number, made modifications, and requested what the dollar amount would be on an annual basis.

Co-Chair Wilson asked for verification that even though adjustments had been made between Tiers I, II, and III, there was still a large liability the state was having a hard time containing.

Ms. Lea answered that the situation described by Co-Chair Wilson was due to the structure of a DB Plan where all of the cost and risk rested with the employer. She detailed that any plan would look well for around ten years because no one was able to retire from it, but once it began maturing two things could not be controlled within the structure. The first was the investment returns on the funds and the second was longevity. When the plans had originally been designed at the turn of the last century, they had been designed to pay out at age 65 when the average life expectancy was significantly less. Currently, there were people receiving benefits from the plans who had worked less years for those benefits than they had been drawing.

Co-Chair Wilson thought it was something that should be examined.

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Mr. Desai moved to slide 5 and reviewed the PERS membership in the DB and DC Plans:

- 157 Member Employers
- 3 Defined Benefit (DB) Plan Tiers
 - 35,139 retirees
 - 5,606 terminated members entitled to future benefits
 - 13,611 actives (40%)
 - 54,356 total DB members
- 1 Defined Contribution (DC) Plan
 - 59 retirees
 - 1,183 terminated members entitled to future benefits
 - 20,811 actives (60%)
 - 22,053 total DC members

Co-Chair Wilson referred to the 35,139 DB Plan retirees and asked how many were in Tiers I, II, and III.

Mr. Desai answered that he would follow up with the breakdown. He moved to slide 6 showing FY 19 PERS contribution rates:

Defined Benefit

Employee:

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

Employer:

- 22% Cost Share

State:

- 5.58% Additional State Contribution

Defined Contribution

Employee:

- 8% All Employees

Employer:

- 5% Investment Account
- 0.94% Health Care
- 0.76% Occupational Death & Disability - Peace Officer/Firefighter
- 0.26% Occupational Death & Disability - All Others
- HRA - flat dollar, 3% of all PERS/TRS average annual compensation

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Mr. Desai turned to slide 8 showing TRS chronology:

- March 1945: Established Defined Benefit (DB) Plan
- 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: Defined Contribution (DC) Plan established

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Mr. Desai moved to slide 9 and reviewed the number of TRS membership in the DB and DC Plans.

- 57 Member Employers
- 2 Defined Benefit (DB) Plan Tiers
 - 12,962 retirees
 - 801 terminated members entitled to future benefits
 - 4,457 actives (47%)
 - 18,220 total DB members
- 1 Defined Contribution (DC) Plan
 - 29 retirees
 - 614 terminated members entitled to future benefits
 - 4,937 actives (53%)
 - 5,580 total DC members

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Co-Chair Wilson asked whether the TRS defined benefits were different than PERS defined benefits. She stated that TRS only included two tiers. She wondered if teachers received a different retirement than public employees.

Ms. Lea answered that there were some structural differences between the PERS and TRS DB Plan. She reported that the benefit formula was somewhat higher on the PERS side because the TRS side included a 2 percent multiplier for the first 20 years and did not increase until the 20th year. Under PERS, a 0.25 percent increase occurred after the first 10 years and another 0.25 percent increase occurred after the 20th year. The total resulted in a 2.5 percent increase beginning in the 20th year. Under police/fire, the number went from 2 percent to 2.5 percent at the 10-year mark. She elaborated that there had been a lower benefit multiplier to calculate the benefits under TRS. Additionally, the group was smaller and there had been less volatility compared to the PERS plan.

Vice-Chair Ortiz looked at PERS membership on slide 5 and pointed to the 40 percent active membership under the DB Plan and 60 percent active membership under the DC Plan. He moved to slide 9 and pointed out the difference between the TRS DB Plan and DC Plan active membership was much smaller

at 47 percent versus 53 percent respectively. He asked for the reason in the difference.

Ms. Lea responded that DRB had not done a study on the issue, but the composition in the two groups was different. She detailed that TRS included professional certificated teachers who usually had a bachelor's or master's degree and tended to be in a career. Whereas, the PERS system had a large turnover and a larger number of people who did not have the same level of education or certificate requirements. She explained the more turnover, the more new employees coming in.

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Mr. Desai turned to slide 10 showing FY 19 contribution rates for TRS:

Defined Benefit

Employee:

- 8.65% All Employees

Employer:

- 12.56% Cost Share

State:

- 16.34% Additional State Contribution

Mr. Desai elaborated that in FY 19, the total contribution was approximately 28.9 percent; 16.34 percent of the number was supported by additional state contributions. He continued with the remainder of slide 10:

Defined Contribution

Employee:

- 8% All Employees

Employer:

- 7% Investment Account
- 0.79% Health Care
- 0.08% Occupational Death & Disability
- HRA - flat dollar, 3% of all PERS/TRS

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Representative Sullivan-Leonard compared the FY 19 contribution rates for PERS and TRS shown on slides 6 and 10. She looked at the PERS DB employee category showing a

9.6 percent school district alternate option. She asked what positions were included in the number.

Mr. Desai replied that the 9.6 percent were performing PERS jobs, not TRS. He asked Ms. Lea to elaborate.

Ms. Lea clarified that the individuals were PERS employees who worked for the school districts for less than 12 months a year. The individuals had elected to pay a higher contribution in order to have their service calculated the way a teacher's service would be calculated. She elaborated that a PERS employee earned service on a day-for-day basis at 0.00274 for each day of the calendar year. A teacher earned a full year of service if they had served 172 or more days in the school year. The alternate option allowed the PERS classified employee in the school district to pay a higher contribution in order to earn a full year of service in a school year even though they may have only worked 9 or 10 months in a year. The burden for the extra cost rested with the employee.

[2:26:23 PM](#)

Mr. Desai moved to slide 12 and reviewed the PERS and TRS balance sheet. He began with PERS DB pension and healthcare figures for 2016 and 2017. The difference between the 2016 assets based on actuarial value of approximately \$16.5 billion and accrued liabilities [of approximately \$21.4 billion] reflected the unfunded liability. He noted that the unfunded liability had increased from approximately \$4.9 billion in 2016 to nearly \$5.1 billion in 2017. Similarly, under TRS the unfunded liability had increased from \$1.7 billion in 2016 to \$1.8 billion in 2017. He reported that combining PERS and TRS resulted in a total unfunded liability of almost \$7 billion as of the last valuation of 2017.

Vice-Chair Ortiz asked for a better definition of unfunded liability.

Mr. Desai answered that under the DB Plans, the employer carried all of the liabilities and responsibility to provide the benefits for a participant's lifetime. He explained that each year DRB determined DB Plan employee benefits as of that day and as of the particular cutoff date. The division determined how much money needed to be put aside to cover an individual's retirement date through

a general life expectancy - the number was determined by certain calculations and the present value was determined. The division considered how much money would be necessary to put aside for a specific individual from the current date to their projected retirement date and then from their projected retirement date to end of life. The present value was then computed across the board for the entire population.

Mr. Desai provided a hypothetical scenario where the value of the money the state needed to set aside was about \$100 million. The state's system assets were determined related to current market value and interest rate and it was compared to the value calculated at present. The difference between the two was the unfunded liability if the value came out to be lower than the assets. If the value was higher, it meant the system was overfunded. He provided an example where the shortfall was \$20 million. The question was whether an unfunded liability was a bad thing. He stated it was a bad thing, but there were no plans in existence that remained fully funded all of the time.

Vice-Chair Ortiz asked Mr. Desai to repeat his last statement.

Mr. Desai complied. He reported there were no plans in the public or private sector that remained 100 percent funded all of the time. Values were based on demographics, actuarial assumptions that changed every four years, and based on market terms and conditions. All of the mechanics went into place and DRB used the method to assume the cost for future payouts. He explained that because it was not possible to know the length of a person's lifespan, the numbers were based on records and reports using the best science. Each year, the exercise was conducted to determine whether the system was on the same track as the year before; it considered whether something had changed in demographics, the market value, and expectations. Future projections were continued to be tweaked up or down depending on the difference in the market.

[2:31:45 PM](#)

Vice-Chair Ortiz asked if there was a public employee compensation plan standard that states attempted to meet. He asked if a rating of unfunded liability existed.

Mr. Desai answered in the affirmative. He detailed that most private sector pension plans were governed by the Internal Revenue Service (IRS) Employee Retirement Income Security Act (ERISA). He relayed that ERISA had established that a funding ratio of 80 percent was considered very healthy and was in the green zone. At 77 percent the zone became orange and below a certain percentage the zone became red. He explained that employers were required to adopt and meet certain guidelines under ERISA and to bring their plan above 80 percent. The private sector considered anything above 90 percent to be a very healthy and secure plan. He reported that in the private sector the target was a funding level of 100 percent. Similarly, Alaska had targeted its PERS and TRS plans to be fully funded by 2039.

Vice-Chair Johnston speculated that if the state aimed for the plans to be funded at 100 percent, the last retirees could be quite wealthy.

Mr. Desai agreed. He explained that once the plan went beyond the 100 percent threshold, mostly on the multi-employer plan, it could not be maintained at that level. The state would have to either lower or stop the contributions from the employer side or increase the benefit to keep the benefit up to the 100 percent level. The highest risk of increasing the benefit with a 100 percent funding level was there was no guarantee that the funding level may not go down and the promised benefit may be taken away. He believed there was a major risk at remaining at 100 percent. He stated that a 100 percent funding level was a great target, but maintaining that number was challenging.

[2:34:36 PM](#)

Vice-Chair Johnston noted that in the past when the system had been severely underfunded the PERS, TRS, and health benefits had accounted for almost one-third each. She asked where the health liabilities had been in the past five years and what percentage of the unfunded liability they accounted for.

Mr. Desai replied that DRB would follow up with the information.

Vice-Chair Johnston thought there had been some actuarial savings.

Mr. Desai agreed to provide the information.

Representative Merrick referenced Mr. Desai's description of unfunded liability as a promise by the state to pay the benefits. She asked what ramifications there were to the state if it did not pay the benefits.

Mr. Desai answered that not many plans were 100 percent funded. Annually, the valuation of the plan was determined as of a specific date; if the plan was underfunded and there was no particular remedy to bring it up to the necessary level, the plan would be at risk. However, if there continued to be a contribution and remedy to pay towards the unfunded liability to meet the targeted level, it demonstrated being in the process of meeting the obligations. He explained that under the circumstance, it was not considered a particular risk. He explained that what the state was trying to fund at present would be cashed out over the next century. He elaborated that it was understood if the plan was not fully funded at present because the state was trying to target 100 percent funding. Once the plan was funded at 100 percent (the 2040 target) the last person collecting a pension check from PERS and TRS would be in 2116 according to the actuarial assumption.

[2:37:23 PM](#)

Representative Merrick asked what would happen if the state did not pay the benefit.

Co-Chair Wilson remarked there would be many angry emails and people.

Mr. Desai answered there were ramifications under the IRS regulations. He detailed the state was required by federal regulations to maintain the funding at a certain level; if that was not followed, the state would be asking for non-qualification of the plan.

Co-Chair Wilson clarified that the legislature did not plan on going down that road.

[2:38:10 PM](#)

Representative Josephson referenced the payment of \$3 billion that had been made towards the unfunded liability

around 2014. He believed the cash infusion had reduced the annual payments to the current \$200 million range. He noted that the payments had previously been as high as \$700 million. He remarked that the large payment had helped stabilize the fiscal picture for the outyears. However, the downside was that effectively the \$3 billion would be lost and consumed by the failure to pay in a different, aggressive amortized way. He believed the benefit of the \$3 billion was the lower payments for the next 10 to 20 years, but effectively the \$3 billion would be gone. He believed it was essentially the payment for enjoying the reduced payment.

Mr. Desai answered if the \$3 billion cash infusion had not gone into the PERS and TRS plans, the current liability could have been much larger. He stressed that the \$3 billion had made a significant difference in bringing both plans closer to a healthy funding level. The \$3 billion would also help to reduce the future contribution. He detailed that the plans were reviewed annually to evaluate whether they were close to meeting assumptions from the past couple of years. In a perfect world, the lower contribution levels would continue. Unfortunately, the market did not follow wishes. Subsequent slides would show expectations of rate returns was different than reality and it changed and impacted all of the additional employer contributions.

Co-Chair Wilson asked what life expectancy the data was based on.

Mr. Desai replied that the number was currently somewhere between ages 83 and 86. When the benefits were computed, the assumptions were used as an average age. He noted that it was an average and some individuals lived shorter or longer lives. The numbers were reviewed annually and were tweaked by a fraction.

[2:41:16 PM](#)

Vice-Chair Johnston asked for verification that the difference between the DB Plan and the Social Security defined benefit was that the parameters of Alaska's DP Plan could not be changed. She did not think the state could specify that an employee could not start receiving benefits at age 55 "and some plans are," or at 65 where most "of us

around here" would not be getting their Social Security at 65.

Mr. Desai replied that the rules were different from plan to plan. In Alaska's DB Plan, the three tiers each had different had different rules established related to the retirement age. Once a plan was set and benefits were calculated, they could not be reduced or changed.

Vice-Chair Johnston referenced Representative Merrick's earlier questions and remarked that the state was mandated to pay the retirement benefits. She asked for verification that the only way the state would be relieved of the responsibility was if it was bankrupt.

Ms. Lea answered that the benefits were guaranteed under the Alaska Constitution, Article XII, Section 7. She stated it became a contract between the plan and the employee; therefore, the state could not diminish the benefits that were in effect as of the date they hired and any increases that occurred during employment and subsequent lifetime. The only way the state could not pay the benefits was if it was bankrupt.

Co-Chair Wilson was happy to report the state was not bankrupt.

Mr. Desai turned to slide 13 and reviewed ARMB long-term returns for the PERS and TRS systems through June 30, 2018. He reviewed the 34-year returns and the 1-year returns:

Annualized Returns	PERS	TRS	Average
34 Year	8.97%	9.30%	9.14%
1 Year	9.61%	9.62%	9.61%

[2:44:18 PM](#)

Mr. Desai moved to the actual rate of return and funding ratio for PERS for the past 20 years. The second column showed the funded ratio for each year, the third column showed the actuarial earnings rate, and the fourth column showed the actual rate of return. He highlighted 1996 as an example and reported that the system's funding ratio was perfect at 105.8 percent. He noted that between 1996 and 2001 the state's actuary had not provided the true factual information - as a result, the information in the actuarial report could be erroneous. He estimated that the number

could be 95 to 100 percent when viewed from a conservative perspective. He pointed out that the earnings rate had been 8 percent, but the actual rate of return had been 13.79 percent, which was very healthy. He noted that the funding ratio had increased to 106.3 percent in 1997. Additionally, the earnings rate assumptions had increased to 8.25 percent and the actual rate of return had increased to 18.18 percent.

Mr. Desai pointed to the rows for 2001 to 2003 where the projected return rate was 8.25 percent. He noted that in 2001 the actual rate of return had been -5.25 percent, meaning the PERS plan had technically lost about 13 percent. Similarly, in 2002, the plan had lost another 5.48 percent (a loss of nearly 13.7 percent). The trend continued in 2003, with a return of 3.67 percent (it was positive, but did not meet the 8.25 percent actuarial earnings rate). In those few years, the plan had lost about 27 percent. He explained it was one of the other reasons the funding ratio had dropped. He reported that history showed that a plan that was 100 percent funded did not always remain at that level; it was not controllable. He continued that it was not that the state paid a high benefit during those years or continued to expand expenses, but the state had lowered employer contributions (because the plan was funded above 100 percent) based on incorrect information, which had resulted in disaster. He reported that ever since, the plan had been trying to return to the 100 percent level.

Representative LeBon looked at the actual rate of return column on slide 14. He asked for the average rate of return for the time period.

Mr. Desai replied that DRB would follow up with the information.

Representative LeBon thought it would be interesting to know if the average actual return was above or below the actuarial earnings rate of 8 to 8.25 percent.

Mr. Desai noted that the ARMB set the rate for 8.25 percent and when the actual returns were lower or higher, the figures are smoothed out. He explained that the returns were not immediately used for the following fiscal year's evaluation. The data was spread over 3 to 7 years. Under one plan, the data was spread over 5 years. For example, if

the plan received a 13 percent return instead of 8 percent, the following year the calculation would only use an additional 1 percent and spread the 5 percent over the next 5 years. He explained that the actuarial perspective over value (what showed in the plan) was different than the market value.

[2:49:11 PM](#)

Vice-Chair Johnston asked what the current best practices earnings rate was for the industry. She understood the rate had been declining. She asked if it was 8 percent.

Mr. Desai answered that the number was reviewed in the actuarial experience study the previous year. The average was anywhere from 7 to 7.5 percent depending on the plan. There were fewer and fewer plans remaining at 8 percent.

Mr. Desai turned to a chart on slide 15 comparing the actual rate of return, funding ratio, and earnings for PERS. The actuarial earnings rate was pretty standard and had been increased to 8 percent to 8.25 percent in 1997. The rate had remained at 8.25 percent until it had been reduced to 8 percent in 2011. He reported that at the last actuarial study the rate had been dropped to 7.38 in the preceding year. Slides 16 and 17 showed the same information (as slides 14 and 15) for TRS. He noted that the chart on slide 17 the actual rate of return and funded ratio moved in similar wavelengths. He noted that the funded ratio was smoothed out over a five-year period.

Representative Sullivan-Leonard asked what occurred from 2007 to 2009 where a large decline [in the actual rate of return] occurred for PERS and TRS.

Mr. Desai answered that the expected return in 2007 was 8.25, which the actual return exceeded by more than 10 percent; however, in 2008 the market had declined between 30 and 33 percent on average for many plans. He detailed that in 2009 the actual rate of return for TRS was -20.62, which was better than the average loss of 30 to 33 percent. The decline had impacted the plans and the result was witnessed in the funded ratio. He noted that the funded ratio dramatically increased from 2014 to 2015 due to the \$3 billion cash infusion.

[2:53:26 PM](#)

Mr. Desai turned to slide 18 and reviewed the actuarial experience study process:

Experience Study Process

Alaska Statute 37.10.220(a)(9) requires an experience study be conducted at least once every four years (healthcare assumptions are reviewed annually as part of actuarial valuations)

- The experience study compares current assumptions with actual plan experience
 - Last study: Performed in 2014. Covered experience for the 4-year period July 1, 2009 through June 30, 2013.
 - New assumptions adopted by the ARMB were effective beginning with the June 30, 2014 valuations.
- Current study: Covers experience for the 4-year period July 1, 2013 through June 30, 2017.
 - New assumptions (and methods) adopted by the ARMB will be effective beginning with the June 30, 2018 valuations (which will be used to set FY21 contributions).

[2:54:52 PM](#)

Mr. Desai moved to slide 19 and discussed the actuarial experience study:

Economic Assumptions

- Investment Return
- Inflation
- Salary Increases
- Payroll Growth

Demographic Assumptions

- Mortality
- Retirement
- Disability
- Withdrawal (termination of employment)

Funding Methods

- Healthcare Normal Cost and Actuarial Accrued Liability
- Administrative Expense Load to Normal Cost

- Amortization of Unfunded Actuarial Accrued Liability (UAAL)

Mr. Desai elaborated on the funding methods section of the slide. He explained that the healthcare normal cost and actuarial accrued liability based on actual practices. The information from the actuarial experience study was brought to ARMB and multiple options were presented to show the biggest effects on the benefit - the interest rates and inflation rate - what the effect would be if something was adopted. The components on slide 19 went into the actuarial experience study before the rate was finalized by ARMB.

[2:56:34 PM](#)

Representative Josephson referenced salary increases shown on slide 19 and assumed it pertained to the high three [years] concept [of a person's employment] - that it could not be known until a person retired. He asked for the accuracy of his statement.

Mr. Desai answered that the salary increases were based on the last assumptions that were intact. He compared the salary increases under the actuarial expense study adopted four years earlier to whatever the amount would be going forward. He elaborated that salary increases also coincided with the active population in the plan, plan participants under DB and DC Plans. He referenced the state's closed DB Plan and its DC Plan where contributions were capped at 22 percent. A portion of the percentage went towards the DB Plan unfunded liability. Salary increases and payroll growth were included as a part of the study.

[2:57:43 PM](#)

Mr. Desai reviewed a recent history related to the actuarial experience study on slide 20:

2009 (Eff 6/30/2010 Valuation)

- Investment Return
8.25% -> 8.0%
- Inflation
3.5% to 3.12%
- Payroll Growth
4.0% to 3.62%

2013 (Eff 6/30/2014 Valuation)

- Investment Return
Stayed at 8.0%
- Inflation
Stayed at 3.12%
- Payroll Growth
Stayed at 3.62%

2017 (EFF 6/30/2018 Valuation)

- Investment Return
8.0% -> 7.38%
- Inflation
3.12% to 2.5%
- Payroll Growth
3.62% to 2.75%

Mr. Desai elaborated on the 2017 data on slide 20. He noted that the investment return of 7.38 percent was comprised of an actual return of 4.88 percent and inflation of 2.5 percent. The rates would be used for the next four years until a new actuarial experience study was conducted.

[2:59:17 PM](#)

Mr. Desai reviewed the DB Plan benefit formula on slide 21:

Defined Benefit Pension:

Fixed benefit amount from date of retirement to death
 $\text{Contributions} + \text{Investment Earnings} = \text{Benefits} + \text{Expenses}$

IF:

Actuarial assumptions are accurate. Funded ratio remains at target of 100%

IF NOT:

Unfunded liability is created, if benefits and expenses are greater than contributions and investment earnings. Funding excess if contributions and investment earnings are greater than benefits and expenses.

Mr. Desai reported that both sides of the equation had to be in balance in order to remain at a funded ratio of 100 percent. He explained that if one side fluctuated the plan could be over or under funded.

3:00:21 PM

Mr. Desai reviewed a history of additional state contributions for PERS/TRS since it had implemented the cost share design (slide 22). Beginning in 2006 the state had contributed nearly \$7.2 billion for both systems for additional contributions beyond 22 percent for PERS and 12.56 percent for TRS.

Mr. Desai moved to slide 23 and addressed projected additional state contributions for PERS and TRS. The information had been comprised based on the 2017 valuation. Additionally, an effort had been made to do the projection based on the recent study. The 2020 projection was based on the 2017 valuation and showed a combined total of \$300 million that would be put forward for the FY 20 budget. He elaborated that FY 21 through FY 39 were based on the projection in the 2017 valuation and partially assuming additional assumption changes. Currently, the actuaries were working on finalizing 2018 numbers to see the true impact of an additional state contribution and what the unfunded liability would be. The information would not be available until May 3 when actuaries would undergo a second actuarial review and ARMB would approve the numbers. The slide showed projected numbers through 2039 for a fully funded plan by 2040.

Co-Chair Wilson stated that if more money was needed in the budget it would have to be addressed by the Senate because the operating budget had already passed the House. She pointed to slide 23 and asked for verification that an additional \$123 million would be required for the FY 21 budget.

3:03:01 PM

Mr. Desai answered that \$123 million was the difference between what the best estimate calculated for FY 20 and FY 21 based on the assumed rate of 7.38 percent. To compare the true number change from FY 21, it was necessary to look at the 2017 valuation numbers. The numbers on the table were calculated based on the new assumptions that would take place for 2018.

Co-Chair Wilson clarified her question. She thought the FY 21 budget would need to include \$423,084,000 in order to keep the liability from growing.

Mr. Worley agreed. He reminded committee members that slide 23 showed an estimate based on numbers from the previous year. The department was currently waiting for the completion of the June 30, 2018 report, which would be adopted by ARMB. Additionally, there was a calculation done in the summer and provided to ARMB at its September board meeting to use more current asset numbers.

Co-Chair Wilson highlighted that the number could be better or worse.

Mr. Worley agreed.

Co-Chair Wilson reiterated that an additional \$123 million would be required in the FY 21 budget to hold even with the FY 20 budget. She remarked on an earlier statement that the liability was only \$300 million. She stated it was substantially higher.

Mr. Worley clarified that the FY 20 numbers shown on slide 23 were included in the budget passed by the House.

Co-Chair Wilson restated that the budget for FY 21 would need an additional \$123 million.

[3:05:14 PM](#)

Representative Carpenter asked for verification that the numbers on slide 23 would change if there was an increase in salary costs or employees.

Mr. Desai agreed.

Co-Chair Wilson believed it only applied to Tiers I, II, and III and did not have the same impact in Tier IV.

Ms. Lea replied in the affirmative.

Co-Chair Wilson noted the state had moved to Tier IV [to contain costs] as numbers increased. She remarked that the change related to who was responsible for covering the increases. She noted there was still a large number of active employees in the first three tiers.

Representative Josephson understood that the figures on slide 23 were projected and there could be a new report

with updated numbers. He thought that if the legislature did not increase expenditures by \$123 million it would effectively be saying it did not care what ARMB thought and it would cross its fingers and hope for massive stock returns and let the unfunded liability grow.

Mr. Desai agreed. He detailed that if the legislature skipped a year of the contributions the unfunded liability would increase. He elaborated it would reflect in the future projections of the unfunded liability. He explained that if the legislature continued to target 100 percent funding for 2039, the number would continue to change to meet the 100 percent requirements; if the contributions were lowered in certain years, the future years would suffer.

Co-Chair Wilson asked if the contribution level would remain at \$400 million if the legislature was okay with an 86 percent funding level.

Mr. Desai replied in the negative. He explained that the number would change because the assumption would make a large difference in the employer contributions. The calculations were strictly based on the target to be fully funded by 2039. The projections were calculated keeping the constant number. He clarified that the 100 percent target was reduced to 86 percent the contribution numbers on the table [slide 23] would be significantly lower.

[3:08:13 PM](#)

Co-Chair Wilson thought Mr. Desai had testified that the state did not necessarily want to be 100 percent funded because it could mean people may stop paying or the benefit amounts may need to be changed. She thought based on earlier statements that an 86 percent funded ratio was healthy. She wondered about the reason for remaining on the trajectory shown.

Mr. Desai answered that a funded ratio of 80 percent was considered to be a healthy ratio (in the green zone) in the private sector monitored by ERISA. Comparatively, most of the public sector recommended a target of 100 percent. In the private sector, 90 percent was considered to be a very healthy funded plan. He clarified that 83 to 86 was the average retiree age he had provided earlier that was used

as an average age used to calculate assumptions for benefits.

Mr. Worley added that the best practice was to have funding progress go up to 100 percent; the state's target was to reach that number by 2039.

Co-Chair Wilson appreciated the point but believed that some people may be amenable to aiming for healthy if it meant an additional increase of \$123 million was not necessary.

Ms. Lea considered the funding target for public versus private plans and explained that Alaska had constitutionally protected benefits. The state could not reduce benefits or stop payments like the private sector if its plan became unhealthy. She explained the target needed to be 100 percent because the state was obligated to pay the benefits as they had been earned.

Co-Chair Wilson did not disagree, but she thought the number may need to be adjusted as the budget was determined.

Vice-Chair Johnston stated that the target was 100 percent and one of the reasons the position was assessed every four years was that the variables changed over time. She surmised the 80 percent funded level with a target of 100 percent was a strong position as long as the state kept reassessing its position and avoided getting to a point of being over funded. She thought there was a fine line between over and under funding.

[3:11:41 PM](#)

Mr. Desai answered that the funding was simply determined by the 100 percent - it was the line where the actuary gave advice in its valuation. Anything below 100 percent was considered unfunded liability, even \$50,000. Anything above 100 percent was considered overfunded. He explained that an 80 percent funding ratio that was considered healthy by the private sector, was still underfunded 20 percent.

Co-Chair Wilson clarified that the committee had not stated the number was healthy, the department had.

Representative Carpenter asked what happened to the numbers if the state added a new defined benefit plan.

Mr. Desai responded the new participants joining a new defined benefit plan would not be able to collect a benefit for the first ten years; they would have to become vested and retire from the system to collect the benefit. Until then, the plan would show as well funded because the plan did not have any expenses. The only time an unfunded liability may occur during that time was if the market returns dropped below the rate of return threshold. Once the plan had been in place for ten years, expenses would begin occurring. He pointed to the formula on slide 21 where contributions and investment earnings were shown on the left side of the calculation. He explained that in the first ten years of a plan there was no expense - the expense portion of the calculation was on the right.

Mr. Desai pointed out it was necessary to consider whether a new plan would be separate from PERS. Comparatively, if a new tier was created, the new tier would follow the 2008 statute requiring employers to pay up to 22 percent and the state to pay anything above that amount. He explained that the point of Tiers II and III was to keep the state's DB Plan healthy via cost-containment. He detailed that defined benefit plans made it easy for participants to receive a benefit as the employer took on the obligations; however, there were no levers determining who would pay the debts when a plan experienced lower returns. The levers were missing under the current defined benefit plan design and as a result many states or other employers look towards hybrid plans.

[3:15:33 PM](#)

Representative Carpenter looked at slide 23 pertaining to projected additional state contributions. He surmised that what Mr. Desai was saying was that the numbers between FY 31 and FY 39 would actually increase.

Mr. Desai agreed. He relayed that the numbers were merely projections based on current returns and assumptions. The numbers would stabilize for the next four years because the assumptions were set in place. He explained that as soon as the next actuarial study was done in four years and if drastic changes were made to the assumptions, the number would make a bigger difference in the future projections.

Representative Carpenter asked what the current industry demand was for defined benefits compared to defined contribution.

Mr. Desai answered that when Social Security had been established in 1935 the life expectancy had been age 60. He explained that it had not been assumed that many of the people would collect the benefit. The thought had been that individuals who lived beyond 60 to 65 would likely only live another seven years; therefore, the plan would be done with the liability and still in surplus. He detailed that defined benefit plans are a Social Security benefit that were adopted by many in the private sector under ERISA and established in 1974 to provide incentive for employees to join a company. He elaborated that when defined benefit plans were lower funded early on, no one paid attention to the funding ratio. The game changed in the 1990s when a large company wiped out promises it made to its employees. He reported that the Pension Plan Act was established in 2006 and made the funding rules very strict for many private sector plans. Ever since, ERISA had looked very closely at plan practices and funding mechanisms in the private sector to ensure plans were fully qualified under IRS regulations.

Mr. Desai continued that in the private sector defined benefit plans were extremely popular because employees did not have to worry about what would happen when they retire at age 65 because the contributions of the benefits were set. He explained that defined contribution plans did not have the same mechanism; the employer did not take on the responsibility. When the defined benefit plans funded ratios started declining in the private and public sector, defined contribution plans surfaced in 1978 (the first 401k plan offered) because it had been determined that the employee had to have some buy-in. Subsequently, the 401k plan had become popular where employers and employees contributed to benefits. He detailed that an employee was required to contribute 5 percent and the employer contributed 2.5 percent for retirement - the employee received an extra 2.5 percent on top of their salary. The 401k plan had become popular and was accepted in the marketplace. He relayed that in the mid-1990s when most plans began to decline (especially under stricter ERISA rules), many employers began taking shortcuts.

[3:20:43 PM](#)

Mr. Desai elaborated that employers began to consider making only defined contribution plans available to participants. There was nothing wrong with making the changes, but the challenge was associated with the failure for employers and employees to understand the differences between defined benefit and defined contribution plans. Under defined benefit plans, employees did not have to manage or worry about their plans. Under defined contribution plans employees had to allocate the money according to their desired retirement goals - the employer was only responsible for providing the employee with available options. He continued that employees were required to learn something about defined contribution plans.

Mr. Desai continued that from the employee perspective, a plan that did not require attention during their non-work hours was more popular than a plan requiring an employee to spend time learning its inner workings during their non-work hours. He explained it was a challenge for DRB because DC Plan employees learned about the plan from DB Plan coworkers, which resulted in making a bad comparison. He elaborated that fundamentally the DC Plan was a great plan if it was managed properly. He relayed that the current percentage was 15 percent.

Mr. Desai reported that DRB told plan participants in its seminars that 20 to 30 percent of a person's earnings was taken by the IRS and another 10 to 15 percent went to gas, clothing, and other. He stated that individuals actually lived on about 50 percent of their salary. He stated that if a person put 15 percent aside and compounded it for the next 30 years, they would have enough money for retirement. Comparatively, the same 15 percent in the DB Plan had a different volume. He explained that the current DP Plan that had a 13 percent savings, which was significant.

[3:23:25 PM](#)

Mr. Desai continued that if the money was invested over 30 years with the proper education, it could provide a person with a substantial retirement income. The plan also offered a lump sum at retirement rather than securing payments for a lifetime like the DB Plan. The risk was that the money could be spent on something like a boat or car when a

person received the lump sum. The DB Plan did not provide a lump sum to retirees. He explained that if a person deviated from their retirement plan the impact could be significantly devastating - a person would not have a retirement income. He explained it took significant planning, education, and partnership with plan sponsors to make the plan work. He underscored that the DC Plan would work; it was a matter of understanding the plan better.

[3:24:51 PM](#)

Representative Carpenter asked whether a defined benefit or defined contribution plan was in higher demand for companies just starting up. He guessed it was likely a company would be looking at a defined contribution plan versus a defined benefit plan because of the large future expense under the defined benefit plan.

Mr. Desai answered that he considered current PERS employees with SBS to have a hybrid plan. The state had a DB Plan for Tiers, I, II, and III and an SBS (defined contribution) plan for the same tiers. He considered whether an individual would choose one or the other or if it was better to have both options under a hybrid plan. He stated that a financial adviser would tell a person it was better if they could manage their own money and it was advisable to have the option. He stated that a hybrid plan provided benefit as a monthly income and the DC Plan provided the flexibility of additional expenses a person may want to use the money for. He cautioned it was important to use the money wisely instead of buying a boat. He reported that by design, both defined benefit and defined contribution plans were extremely strong.

[3:27:38 PM](#)

Representative Merrick clarified that she was not suggesting that the state should not pay the benefits it owed. The purpose of her question had been to make sure people knew the state was mandated to pay the benefits.

Ms. Lea reported that DRB used two sources of information to see what was going on with other states including the National Conference of State Legislatures (NCSL) and National Association of State Retirement Administrators. Both entities had studies on current legislation in other states that DRB could provide to the committee.

Predominately other states were either moving to a DC plan or a DB/DC hybrid plan.

Mr. Desai turned to a bar chart on slide 24 showing the unfunded liability for PERS (shown in blue) and TRS (shown in red) from 2003 to 2017. He highlighted that the unfunded liability was about \$7 billion in 2017. Slide 25 showed the updated funding ratio for PERS and TRS with 2017 results for the DB pension and healthcare. The slide included the actuarial accrued liability, valuation of assets, and the funding ratio. As of 2017, the funding ratio was 76.7 percent for PERS and 82 percent for TRS.

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Mr. Desai moved to slide 26 showing the PERS funding ratio history from 1979 to 2017. He pointed out that in 1986 the funded ratio had reached 102 percent. The ratio had ranged from 91 percent to 100 percent over the following ten years and had reached 106 percent in 1996. He pointed out that from 1996 to 2001 the numbers could be overstated [due to the state's actuary at the time]. The funded ratio had dropped from 101 percent to 75 percent in 2002; the major factor in the decline was due to poor market returns. He reported that the state had been struggling to bring the funded ratio back to its prior level ever since. In 2015 the ratio had jumped to from 70 to 78 percent showed the significant impact of the \$3 billion cash infusion. He briefly turned the TRS funding ratio history from 1979 to 2017 on slide 27.

Mr. Desai addressed the PERS contribution rates on slide 28. He highlighted that when the shared contribution plan had been established in 2008, employers were paying 22 percent and the additional state contribution fluctuated based on the actuarial valuation study. He pointed out that in 2012 the additional contribution covered by the state was 11.49 percent. The shaded area between the blue and red lines represented the additional state contribution. Slide 29 contained similar information for TRS.

Representative Sullivan-Leonard asked Mr. Desai to review slide 29.

Mr. Desai discussed that employer contribution rates for TRS were capped at 12.56 percent beginning in 2008; any contribution above that amount was paid by the state. Slide

30 showed the projected retirement population growth. Projections showed that somewhere around 2027 or 2028 the highest population of the retirees under PERS and TRS would be reached. After that time, the number would begin to decline.

Representative Sullivan-Leonard looked at slides 28 and 29 related to the PERS and TRS employer contribution rates. She noted that the TRS contribution had been reduced from 26 percent in 2007 to 12.56 percent in 2008. Whereas, the PERS contribution rate had increased from 21 percent in 2007 to 22 percent in 2008. She asked why the TRS contribution rate was not 22 percent as well.

Ms. Lea answered that the slide reflected legislation that passed in 2008 changing both systems from an age and employer plan where each employer had its own rate, to a cost-share plan where everyone in the system shared the cost. The legislation had set the contribution rates at 12.56 percent for TRS and 22 percent for PERS.

Representative Sullivan-Leonard asked why the contribution rate for TRS had been reduced to 12.56 percent.

Ms. Lea answered that at the time, the contribution rate for TRS had been about 12.56 percent.

Representative Sullivan-Leonard thought the chart on slide 29 showed the contribution rate had 26 percent at one point and it had been reduced to 12.56 percent. She was trying to figure out the rationale.

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Ms. Lea answered that TRS was already a cost-share program at that time. She shared that number shown in 2007 reflected the normal cost share rate and the past service rate totaling 26 percent. As of 2008, the contribution rate had been capped at 12.56 percent, which was the normal rate at the time.

Mr. Desai moved to a graph on slide 31 reflecting the basic facts of PERS and TRS benefits from 2018 to 2090. The graph showed that the state would make its highest payment around 2038 or 2039. He detailed that the state would pay approximately \$133 billion in benefits payments over the next 94 years. The PERS and TRS account balance was \$25.3

billion as of June 30, 2018. The unfunded liability as of June 30, 2017 was \$6.9 billion. The chart showed how much the state would pay annually until the last person received a benefit.

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Representative Josephson referenced the \$133 billion in benefit payments over the next 94 years on slide 31. He asked for verification that much of the figure pertained to the DC Plan, not the DB Plan.

Mr. Desai answered that slide 31 reflected DB Plan benefits only.

Representative Josephson thought that much of the figure pertained to the status quo - the 22 percent [employer contribution rate for PERS] or the 12.56 percent [employer contribution rate for TRS]. He asked for verification that if the state only had a DC plan, the number on slide 31 would be similar. He thought the figure would be approaching \$100 million under a DC plan only.

Mr. Desai responded that under the DC Plan there were two choices - when a participant left, they could leave their money in the plan and draw on it when needed or could purchase an annuity (the state purchased those through a third-party insurance company). Under the DB Plan, the state started making guaranteed benefit payments. The state assumed the benefits would continue to grow until the last person retired from the system in 2039. He explained the state would know what its monthly payments would be going forward until the last person received a benefit from the system. The data was a projection, but it was close to actual numbers based on current populations and retirees. Each year members under the DB Plan were increasing their benefit (based on their salary and additional year of service), which was reflected annually in the actuarial valuations. The chart was a projection of the estimated payment amount up to the last person receiving benefits.

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Representative LeBon noted a reference had been made earlier about tracking other state's activities regarding defined benefit, defined contribution, and hybrid plans. He noted that the state had moved to the DC Plan about ten

years back. He asked if DRB had seen an aggressive move towards DC plans nationwide during that ten-year period. He wondered if Alaska was in the lead on the DC approach.

Ms. Lea answered that DRB frequently received requests from other states related to how the plan balances were accruing because there were many states contemplating what they wanted to do. She shared that Alaska was one of three other states with a DC plan - the remainder were changing to a hybrid DB/DC plan.

Representative LeBon asked if the difference between DB and DC plans was that employees were insured through a DC plan.

Ms. Lea answered that a hybrid DB/DC plan included a DB plan that was very similar to Alaska's legacy PERS and TRS plans but with a significantly reduced benefit with smaller multipliers. She detailed that Alaska's legacy plan multipliers were 2, 2.25, and 2.5 percent. The hybrid plan also included an individual investment account that contributions were invested into; the two things combined provided the retirement benefit. In some of the plans there was a requirement to annuitize a portion of the DC plan and others had no requirement but an individual still received their lifetime small benefit from the DB side.

Representative Carpenter asked if the \$133 billion included an assessment or projection of salary increases for each one of the employees that would be drawing into the future. Alternatively, he wondered if the figure reflected current salary rates.

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Mr. Desai agreed. He detailed that salary was also projected, along with participants' additional submissions up to their retirement date. The actuary would continue to project the service for DB Plan participants to their retirement date. The actuary would also continue to assume the what a participant's benefit calculation would be based on the actuary experience study adopted by ARMB and salary draws. Additionally, the actuary would calculate how much an individual would collect up to their life expectancy. All of the numbers added up to \$133 billion.

Representative Josephson asked if the other savings in hybrid plans was that many did not provide healthcare

between retirement and Medicare. He noted that the state's legacy plans provided healthcare, whereas current legislative proposals did not provide healthcare during that window.

Ms. Lea agreed. The most expensive healthcare was pre-Medicare age. Under most plans, once an individual was eligible for Medicare, the retiree plans became secondary to Medicare, which resulted in a savings. She noted it did not exist in the pre-Medicare age group. She elaborated that it was true some of the newer plans proposed in other states did not include healthcare at all. She relayed that many state and municipal plans already did not provide healthcare.

Representative LeBon asked for verification that if a hybrid plan employee retired at age 55 and had to wait ten years to be eligible for Medicare, they could continue to be in the healthcare plan by paying a premium.

Ms. Lea answered it was a possibility that depended on how the plan was designed. She detailed a plan could be designed so the participant paid the full premium for coverage during that period.

Representative LeBon remarked that the situation would be very unusual in the private sector. He shared that he had retired from a private sector employer and did not have the option to continue in their health plan beyond a brief period of several months.

Co-Chair Wilson thanked the presenters. She reviewed the agenda for the following meeting.

ADJOURNMENT

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The meeting was adjourned at 3:47 p.m.