

SENATE FINANCE COMMITTEE  
February 13, 2020  
9:00 a.m.

9:00:25 AM

CALL TO ORDER

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

MEMBERS PRESENT

Senator Natasha von Imhof, Co-Chair  
Senator Bert Stedman, Co-Chair  
Senator Click Bishop  
Senator Lyman Hoffman  
Senator Donny Olson  
Senator Bill Wielechowski  
Senator David Wilson

MEMBERS ABSENT

None

ALSO PRESENT

Senator Cathy Giessel; Ajay Desai, Director, Division of Retirement and Benefits, Department of Administration; Emily Ricci, Chief Health Administrator, Division of Retirement and Benefits, Department of Administration; Kevin Worley, Chief Finance Officer, Division of Retirement and Benefits, Department of Administration; Kathy Lea, Chief Pension Officer, Division of Retirement and Benefits, Department of Administration.

SUMMARY

PRS/TRS UPDATE

Co-Chair Stedman stated that the presentation would pertain to the ongoing review of the state's retirement system and funding levels. The presentation would consider history as well as projections. He asked testifiers to refrain from using acronyms.

^PRS/TRS UPDATE

[9:02:39 AM](#)

AJAY DESAI, DIRECTOR, DIVISION OF RETIREMENT AND BENEFITS, DEPARTMENT OF ADMINISTRATION, discussed his background. He had worked for 33 years in pension and health administration. He had strong IT development background. He had actuarial and regulation experience. He had started with a bank corporation and had worked with Walt Disney company and the motion picture industry in Hollywood before coming to Alaska in 2017. It was his fourth year with the division.

EMILY RICCI, CHIEF HEALTH ADMINISTRATOR, DIVISION OF RETIREMENT AND BENEFITS, DEPARTMENT OF ADMINISTRATION, discussed her background. She had been working with the division since 2016, focusing on healthcare policy and then taking the lead in operations and policy early in 2019. She had worked in various state government positions, focusing on health care policy for the state's plans, as well as the Medicaid program.

KEVIN WORLEY, CHIEF FINANCE OFFICER, DIVISION OF RETIREMENT AND BENEFITS, DEPARTMENT OF ADMINISTRATION, discussed his background. He was a graduate of the University of Alaska Fairbanks. He had worked in public accounting for four years before relocating to Juneau in 1990. He had been with the division in various capacities off and on since 2000.

[9:05:39 AM](#)

Mr. Desai wanted to discuss significant numbers that would be considered in the presentation. He explained that effective January 2019, the division had implemented an employee group waiver plan in order to receive a higher subsidy from the federal government. The project had been "on the radar" for the previous several years, but the division had not had the necessary strength, support, or partnerships. He thanked Ms. Ricci and others for their work on the project. He noted there had been strong support from the Alaska Retirement Management (ARM) Board. He thanked the Retiree Health Plan Advisory Board, which had a significant role in the project. He extended gratitude to Optimum RX.

Mr. Desai discussed the presentation "PERS/TRS 2020 Update" (copy on file).

Mr. Desai looked at slide 2, "Organization - PERS / TRS," which showed a flow chart. He stated that the division worked with the Department of Revenue and the ARM Board on the different subject matters. Effective October 1, 2005; the ARM board began serving as a trustee for the pension and retiree health trust, as well as the state's supplemental annuity and deferred compensation plans.

Mr. Desai spoke to slide 3, "Membership (as of June 30, 2019)," which showed a table. The slide had been expanded from the previous year to include more detail. He pointed out the plans and tier levels of plan members. He detailed that all of the participants and members would total around 101,000. He cited a ratio of 37 percent to 63 percent for active participants in the defined benefit plan compared to the active participants in the defined contribution plan.

[9:08:39 AM](#)

Co-Chair Stedman asked for a brief explanation of a defined contribution plan and a defined benefit plan.

Mr. Desai explained that prior to 2006, the state offered all employees a defined benefit plan, which was a predefined benefit similar to social security, that would pay a monthly pension after retirement. The defined contribution plan was effective in 1978. The plan offered a lump sum upon retirement. He added that there was also the option for an annuity. Any participants hired under the Public Employees Retirement System (PERS) or the Teachers Retirement System (TRS) after July 1, 2006 would be eligible for the defined contribution plan.

Mr. Desai referenced slide 4, "AlaskaCare Employer Group Waiver Plan Update":

- An Employer Group Waiver Plan (EGWP) is a group Medicare Part D prescription drug plan option.
- EGWP provides a direct subsidy which allows it to be considered when calculating the Other Post-Employment Benefits (OPEB) liability under both GASB & FASB accounting schemes.
- The implementation of EGWP reduced 6/30/18 healthcare liabilities by \$959M, which resulted in

lower projected liabilities, lower projected contribution rates, and lower projected Additional State Contributions (\$711M for PERS, \$248M for TRS).

Mr. Desai detailed that the slide discussed the largest group of members.

Co-Chair Stedman asked about the implementation of EGWP.

Mr. Desai stated that EGWP was originally named the Retired Drug Subsidy Program (RDS). When the EGWP came along, there had been complications in implementation. Many private and public sector plans elected to implement the plan.

Co-Chair von Imhof commented on the savings listed on slide 4. She hoped that the management of prescription medications for the Medicare population could continue.

Mr. Desai thought it was important to note that the state would continue to receive the subsidy that was started in 2019, which would help reduce employer contributions.

[9:12:55 AM](#)

Mr. Desai turned to slide 5, "EGWP Projected Subsidy for 2019," which showed a table listing the types of funding that would be received for 2019. He pointed out that the total added up to \$52.9 million. He stated that it took about 6 months to reconcile claims with the federal Centers for Medicare and Medicaid Services (CMS). He stated that once the numbers were reconciled it would be possible to see yearly totals.

Senator Wilson asked if the \$52.9 million total represented the annual subsidy.

Mr. Desai answered in the affirmative.

Senator Wilson asked if the amount of the subsidy would be annually consistent or if there would be a trend.

Mr. Desai stated that the subsidy was annual, but the number could fluctuate. He asked Ms. Ricci to expand.

Ms. Ricci stated that it was anticipated that the different subsidies would vary according to a number of different factors. Some of the subsidies varied through a risk

projection based on the disease and condition burden across the state's retirees. The division continued to monitor any changes at the federal level that might impact how CMS calculated anticipated subsidies. She did not foresee major changes in the overall amount in the coming years but reminded that the amount was always subject to changes at the federal level via regulation, which was monitored by the division.

Mr. Desai added that the savings had been higher than originally estimated.

Co-Chair Stedman relayed that the committee faced many challenges and rarely had successful financial issues in front of the members. He was pleased at the substantial savings shown.

[9:16:24 AM](#)

Mr. Desai considered slide 6, "Additional State Contributions - Projected (6/30/2018)," which showed the projected numbers of state contributions based on an evaluation from July 30, 2018. He qualified that the numbers would have been much higher in the absence of the EGWP implementation.

Mr. Desai displayed slide 7, "Additional State Contributions - History," which showed that from 2008 through 2020, the state had contributed about \$7.5 billion into the PERS and TRS systems.

Co-Chair Stedman asked if Mr. Desai could discuss the recurring costs for employees and the unfunded liability.

Mr. Desai stated that the additional state contributions helped the unfunded liability. Under PERS employers were required to make a maximum 22 percent contribution, and under TRS were required to make a 12.56 percent contribution. The contributions were paid by the state and went towards the unfunded liability.

Co-Chair von Imhof looked at the big contributions shown for 2015. She had anticipated a jump and wondered what could affect the numbers to go up in a short period of time.

Mr. Desai stated that the numbers on the slide were projected and amortized. If the amount was paid in a lump sum, the unfunded liability was projected to be \$6.6 billion in total. The numbers in the later years were more cash-based and as a result were higher. The numbers were consistent because they were based on the same rate of expectation.

[9:19:28 AM](#)

Mr. Desai highlighted slide 8, "Investment Experience":

The actuarial value of assets was reinitialized to equal fair value as of June 30, 2014. Beginning in FY15, the valuation method recognizes 20% of the investment gain or loss each year, for a period of five years ("Smoothing").

Mr. Desai addressed a table on slide 8. In any given year if the returns were higher than expected, only 20 percent of the gain or loss would be recognized. The actual earning rate of PERS and TRS for 2018 was about 8 percent. If computed using the smoothing over a five-year period, the amount would be 6.1 percent and 6.2 percent for PERS and TRS respectively. He discussed rates for 2019, and the smoothing effect.

Co-Chair Stedman asked if the unfunded liability was calculated from the smoothing the actuarial value of the assets.

Mr. Desai answered in the affirmative. He stated that any time one viewed the actual value of the assets lesser the earning rates, chances were that the funding ratio would decrease at some level. He stated there were many other factors included in the funding ratio.

Mr. Desai looked at slide 9, "Funded Status - Valuation Results (\$000's)," which showed a table. He pointed out that the slide showed the total funding results for PERS and TRS. He pointed out that the funded ratio of PERS was slightly higher in 2019, and the same was true for TRS.

Senator Wielechowski was curious about the dates for the 2019 draft amounts. He pointed out that the stock market was up 30 percent for the last year. He wondered if valuation of assets would increase.

Mr. Worley stated that valuation reports were dated as of June 30, 2019; and only recognized half a year of investment gains as mentioned by Senator Wielechowski. He relayed that the second half would not be seen until the June 30, 2020 valuation.

Mr. Desai addressed slide 10, "Funded Status - Valuation Results (\$000's)," which showed a table with a breakdown of the total, specific to the defined benefit pension plan. He noted that in 2018, the actual funded ratio had dropped. He added that the funded ratio for TRS had gone up.

[9:24:33 AM](#)

Senator Wilson asked for an explanation of the factors and why PERS was reducing.

Mr. Desai recalled that in 2018 there had been an actuarial experience study, which realigned all the factors. There were many factors connected to determining the value of the plans at any time. For 2018, the division had used an expected rate of 7.3 percent, which had changed the projection.

Co-Chair Stedman asked if the numbers were good or bad. He wondered if people listening should be worried about pension checks.

Mr. Desai thought the numbers were just numbers. He mentioned federal guidelines as to how the plans were supposed to be funded. He thought the good news was that the state put a plan funding ratio in place ten years previously. He thought it was important to understand that although the ratios were changing, there was policy of how to meet the state's obligation. Participants were receiving benefits. He thought the ratio showed that the state had to extend to meet benefits in the future. The good news was that the state was targeting to meet the 100 percent funding requirements by 2039, and the state had enough funding to pay checks to participants. He did not think participants had to worry about pension checks. He thought people should be pleased that the state was committed to making the plan 100 percent funded by a certain date and already had plans in place.

Mr. Desai advanced to slide 11, "Funded Status - Valuation Results (\$000's)," which showed a table. He pointed out that under PERS the funded ratio went up for 2018 and 2019; and there were similar results for TRS. He thought the changes were a direct impact of the EGWP implementation.

[9:28:54 AM](#)

Co-Chair von Imhof thought in the past the committee had heard the healthcare portion, rather than the pension portion, had risen and incurred higher costs. She thought it was good to see the state was over 100 percent of the funded ratio. She asked what other efforts were being made to control the healthcare cost curve. She mentioned coordinated care and the continuum of care. She suspected that the savings could get eaten up as the cost of healthcare increased over the consumer price index (CPI) each year. She was hoping to hear how the state was going to maintain the funding ratios.

Co-Chair Stedman asked for commentary on the ability to strengthen the pension side of things.

Ms. Ricci explained that particularly with the retiree health plan, implementing changes had to be done incredibly carefully. The EGWP had been available to the division for at least six to ten years, but for a variety of reasons it was not viewed as feasible. There was a narrow window of success with any potential changes made. She stressed the importance of being able provide the same or increased level of benefit without adding to the unfunded liability. She detailed that there were two paths the division was continuing to pursue regarding health plan management. She discussed the way the division contracted. She relayed that she was one of twelve staff that was fully focused on managing the health plans. The staff did not perform the functions of the health insurer but did manage contractors.

Ms. Ricci continued to address Co-Chair von Imhof's question. She stated that the division focused on leveraging contracts to get the highest level of stability and competitive advantage. She used the example of the recent contract with Optimum RX that was implemented in 2019, which had an initial three-year period with up to six one-year renewals. The contract allowed for initial stability as well as annual leverage to renegotiate pricing.

Ms. Ricci mentioned another \$27 million in savings achieved as a result of renegotiating contracts. Further savings were expected to be negotiated at a mid-market check in two months. The division wanted to achieve additional savings in medical services through ensuring the best pricing and value was achieved in everything that was negotiated.

[9:33:47 AM](#)

Ms. Ricci addressed another pursuit of the division. She reiterated that the division, in addition to pursuing savings, worked towards providing equal or better benefits for retirees. Prior to the creation of the Retiree Health Plan Advisory Board in 2018, the division did not have a formal avenue to engage in the retiree community. A board was established and was a mechanism through which the division was pursuing additional changes. Some of the changes were focused on modernizing the retiree health plan. Health plans and benefit expectations had changed since the last time the changes were considered twenty years previously. There was a combination of changes that would benefit members, such as adding preventive care and looking at a lifetime maximum. The current lifetime maximum was \$2 million. In 2000, the amount was reasonable; but the amount needed to be updated.

Ms. Ricci mentioned that any time benefits were added, it was important to consider an offset to balance an additional cost to the system. The division was focusing on offsets that allowed the state to leverage its purchasing power. She did not think the current plan design put the state in the best position for negotiation with providers or vendors. The division was focusing on whether the plan allowed the state to pay for what it wanted to receive. She thought in some areas, the plan was designed in a way that added cost but did not necessarily benefit members.

[9:36:34 AM](#)

Senator Wilson asked about over-funding of the defined benefit plan. He asked about what the division or the ARM board had in mind for the funding, and whether it could be reinvested into the fund.

Mr. Worley stated that the division considered what to do with the asset allocation of the overfunding. The subject

had been brought up by the ARM Board. He noted that pension and healthcare were invested in a similar manner. He pondered if there were ways to diminish risk on the healthcare side. He pondered whether funds could be shifted from health to pension, and informed that the shift was not allowed due to Internal Revenue Service (IRS) code.

Co-Chair Stedman thought different risk level strategies could be addressed in greater detail when there were consultants before the committee. He thought it was nice to have one side of the retirement system fully funded.

Senator Bishop commented that healthcare might be currently overfunded, but if the state looked at increasing the limit, the overfunding might evaporate.

Ms. Ricci stated that the division had to achieve a balance between ensuring added benefits were offset by savings. There were strict criteria outlined by the court that the division used as a guide. She pondered that generally healthcare costs continued to climb, and even if there were no efforts to modernize the plan for the next ten years, she anticipated there would be erosion in the funding ratio from the nature of healthcare cost inflation.

Co-Chair Stedman commented that there had been a problem as Ms. Ricci described in the past, particularly with TRS.

[9:40:43 AM](#)

Mr. Desai looked at slide 12, "Historical Rate of Return and Funded Ratio," which showed a table. He pointed out the changes in assumed actuarial funding rates starting in 1996. After the actuarial study in 2018 there was expectation of a funding ratio of 7.38 percent, which had been used for calculations. The second column under PERS showed actual returns, starting with 13.79 percent. He pointed out the drop in the actuarially funded ratio in 2002. There were many factors involved in any change in the ratio, but he thought the key point was that the red numbers on the table correlated with a drop in the ratio. One of the key factors was market returns.

Co-Chair Stedman thought the funding ratio for TRS had increased, and PERS was also making progress; although slow.

Mr. Desai agreed.

Mr. Desai spoke to slide 13, "Funded Ratio - History (Based on Actuarial Valuation Reports)," which showed a bar graph. Since 2011 the ratio had been steadily going up. He referenced Co-Chair von Imhof's earlier comments and noted that in 2015, the additional state contribution of \$3 billion dramatically brought the funding ratio to a higher level. The rate was steady for the recent few years and he hoped it would rise.

[9:43:33 AM](#)

Senator Hoffman noted there was a drastic drop of the funded ratio from 2001 to 2002. He asked what measures the division had made so that such a drop would not happen in the future.

Mr. Desai stated that the ratio prior to 2002 was high and reiterated that the numbers were questionable. There had been measures put in place, and there was a secondary actuary put in place to review the work of the primary actuary. He noted that the ARM Board now met regularly, and there were many components of the evaluation.

Co-Chair Stedman recalled that in 2002 when there was a precipitous drop in the funding ratio, there had been issues surfacing such as erroneous previous calculations that had led to litigation. There had been a requirement by the committee that the actuary was reviewed by another actuary to avoid another similar situation. He thought the numbers in the early part of the chart should be taken with a grain of salt. He thought the line from 2002 showing a drop down to 75 percent was a more accurate depiction. He noted that the practice of having a secondary actuarial review continued.

Mr. Desai noted that there was another significant drop; in 2001, 2002, and 2003 returns were very low. He pointed out that in 2001 and 2002 the returns were negative. There was an altogether loss of 30 percent of what was expected over the three years.

[9:47:46 AM](#)

Mr. Desai referenced slide 14, "Unfunded Liability - PERS/TRS (\$000's)," which showed a bar graph. He pointed out the total unfunded liability of about \$6.6 billion.

Co-Chair Stedman thought the state had been making some progress from peaking at \$12 billion in unfunded liability.

Mr. Desai stated that there had been good progress towards lowering the unfunded liability. He thought, based on studies that had been done, that the funds were more in line with the rest of the marketplace. He thought there was alignment of all the actuarial studies done in the past year. He believed the trend going forward was positive, and the state was moving in the right direction.

Mr. Desai turned to slide 15, "Employers and Additional State Contributions Projection," which showed a flow chart depicting the process of the allocation of projected employer and additional state contributions. He noted that the timeline showed how the rates were calculated using the previous two years data. He pointed out that the rates for 2022 would be calculated using the 2019 valuation, which would be completed by March 2020.

Co-Chair Stedman thought the slide related to Senator Wielechowski's question regarding the calendar year versus the fiscal year, and the rate of return. He thought the higher returns would factor into the calculation for the following year.

[9:51:00 AM](#)

Mr. Desai considered slide 16, "FY2021 Contribution Rates - DB Plans," which showed a table. He pointed out the 6.75 percent employee contribution. Police officers and fire fighters contributed 7.5 percent, and school district alternate options contributed 9.6 percent. Under TRS there was a flat contribution rate of 8.65 percent. The employer contribution was 22 percent under PERS and 12.56 percent under TRS. He pointed out that the total required contributions for FY 21 were 30.85 percent for PERS and 30.47 percent for TRS. The additional state contribution was 8.85 percent.

Co-Chair Stedman discussed the state's contribution and unfunded liability. He asked if the 22 percent was going

back to the municipalities or hospitals and PERS membership programs.

Mr. Desai answered in the affirmative. He stated the portion of the unfunded liability was paid from the 8.85 percent. Some portion of the 22 percent employer contribution went toward the unfunded liability.

Mr. Desai displayed slide 17, "FY2021 Contribution Rates - DC Plans," which showed a table indicating that employees contributed about 8 percent for both PERS and TRS. He discussed contribution rates on the table. The remaining portion of the 22 percent state contribution would go towards the defined benefit plan's unfunded liability.

Co-Chair Stedman asked about the 0.7 percent contribution for peace officers and fire fighters. He asked what benefit would be delivered if something happened to a peace officer or firefighter.

[9:54:53 AM](#)

KATHY LEA, CHIEF PENSION OFFICER, DIVISION OF RETIREMENT AND BENEFITS, DEPARTMENT OF ADMINISTRATION, discussed her background. She had worked in the division for 30 years. She addressed Co-Chair Stedman's question regarding death and disability benefits. Under the defined contribution plan, there was only occupational death and disability. Under the defined benefit plan, there was both non-occupational and occupational death and disability. The reason the peace officer and firefighter rate was a little higher was due to a provision that other employees did not have, and under occupational death and disability would receive a percentage of current salary. at the time of normal retirement, the disability ceased. Peace officers could continue to receive the disability benefit by forfeiting the investment account. All other employees had benefits cease at normal retirement age.

Co-Chair Stedman asked about what would happen if there was a death on the job.

Ms. Lea stated that for an occupational death, the survivors would have the choice to receive a monthly benefit payment based on a percentage of the salary of the peace officer or firefighter. The benefit would be received until the normal retirement age of the employee; at which

point the death benefit would stop and the contribution account could be drawn down for benefits. The employer would pay the employer and employee contributions to a separate account established at the time of death.

[9:58:41 AM](#)

Co-Chair von Imhof wanted to point out that there was a 'Health Care' line on the table on slide 17 that was different than state payment of monthly healthcare premiums. She thought the state paid more than 1.27 percent of an active monthly healthcare cost.

Ms. Lea asked if Co-Chair von Imhof was referring to retiree health care.

Co-Chair von Imhof asked what the state paid for retiree health care.

Ms. Ricci addressed Co-Chair von Imhof's question. She relayed that the state paid a per-member per-month amount for employee health insurance, in the amount of \$1550. There were only about 60 participants in the defined contribution health plans for retirees, which had been set up three years previously. The premiums established for the plan reflected actuarial expectations rather than the reflecting the actual experience of the plan. She continued that depending on the various defined contribution retirees' personal circumstances, members may be responsible for a certain percentage of the premium upon retirement.

Co-Chair von Imhof would follow up with Ms. Ricci at a later time regarding healthcare costs and the state's responsibility for active employees and retirees.

Mr. Desai highlighted slide 18, "Contribution Rates - History," which showed two line graphs with contribution rates for PERS and TERS from 2008 to 2020. He explained that the flat rate on the top chart was 22 percent. The orange line showed the gap between the 22 percent and the required rate for each year. The chart illustrated how much additional state contributions were put into the pension systems.

[10:02:59 AM](#)

Mr. Desai looked at slide 19, "Projected Pension Benefit Recipients," which showed a line graph. He noted that the slide had been modified from previous presentations to show more information. He noted that the slide showed the count of pension recipients by year and when the numbers would peak. It was projected in 2020 that the state would be paying over 50,000 retirees by the end of the year. The highest number of people to be receiving benefits from both systems would be in 2028, which included retirees, beneficiaries, and disabled retirees.

Mr. Desai addressed slide 20, "Projected Pension Benefits Payment (\$000's)," which showed a line graph. He noted that the orange line showed that in 2020 the state would be paying about \$1.4 billion a year in pension benefit payments for PERS and TRS. By 2036, the number would peak at about \$2 billion per year; after which the number was expected to decline.

Senator Wilson asked about the average timeframe of when an employee retired until no longer on PERS and TRS. He wondered if the average age had changed in recent years.

Mr. Desai did not have the numbers at hand. He offered to get back to Senator Wilson with the information.

Co-Chair Stedman asked if it was possible to get a breakdown of what percentage of the projected 2020 pension benefits payment was going to residents versus non-residents.

Mr. Desai stated that he could provide the information broken down as described. He continued that more than 40 percent of retirees lived out of state.

Co-Chair Stedman asked for historical information on the number of retirees living out of state so as to see a trend.

[10:06:08 AM](#)

Co-Chair von Imhof hoped to combine slide 20 and slide 6, which showed additional state contributions. She considered the orange line that showed a peak in payments in 2036. She asked if the amounts shown on slide 6 were expected payments for the out years.

Mr. Desai answered in the affirmative. He explained that the division looked at the total assets of both plans. The total assets of the plan would be used until the last payment was made to the last retiree. He calculated that if the state had a fully funded plan by 2039, the assets would be at a different level. There was not a direct connection between the slides. He discussed using a pie chart to calculate the unfunded liability piece of payments.

Co-Chair Stedman thought the unfunded liability was re-amortized every year.

Mr. Worley explained that in 2014, after the initial \$3 billion contribution to PERS and TRS there had been a provision to re-amortize at a 25-year level, which set the payout at 2039. Most recently, through the experience study (recently adopted by the board) there was a move to start adding layers. The division would create a new 25-year layer each fiscal year there was an evaluation report done.

Co-Chair Stedman asked if the change would decrease the annual cash-flow requirements to feed the unfunded liability.

Mr. Worley stated that the division expected to pay off the unfunded liability by 2039; but the smaller layers could push the date out. The smaller layers could go away if the fund had a good year.

[10:10:10 AM](#)

Co-Chair von Imhof thought it would be helpful to look at variables such as peak population. She focused on how much the state owed. She asked about options for planning future funding.

Mr. Desai stated that based on the current requirement, the division could consider the goal under statute, that both plans would be funded at 100 percent by 2039. He stated that the division looked at the entire picture every four years, in order to determine expected contributions. Factors such as age and life expectancy were considered. He referenced slides 9 and 10, which showed a change in the funded ratio as a result of a study.

Co-Chair Stedman asked if the expectation of payoff by 2039 was in statute.

Mr. Desai answered in the affirmative. He reiterated Mr. Worley's remarks about adding additional layers every 25 years, which would help stabilize additional state contributions.

Senator Wielechowski compared slides 19 and 20. He asked why the number of pension recipients seemed to peak in 2028, but the benefits peaked in 2036.

Mr. Desai stated that one explanation could be that once a participant retired, the state was obligated to provide cost of living adjustments and post-retirement benefits based on the CPI Index adjustments. Once a participant retired, benefits would increase.

Co-Chair Stedman asked Mr. Desai to provide additional detail at a later time.

Mr. Desai advanced to slide 21, "Health Care Cost Trend Rates," which showed a table with trend rates from 2019 until 2050. The information had been requested the previous year and showed pre-65 and post-65 projected medical cost rates. He mentioned the rising cost of healthcare.

[10:15:56 AM](#)

Mr. Desai looked at slide 22, "Termination Studies and Termination Costs,"

Summary of Termination Cost

- Cost of the actuarial study - paid by employer
- Cost to fund future benefits for employees being removed from coverage
- Ongoing Contributions required until unfunded liability is extinguished

Source: Buck - Trend rates used in the 6/30/18 valuation were updated from the 6/30/17 assumption

Co-Chair Stedman noted that he had requested the information on the slide. He mentioned that termination studies were an important topic at the local level and had significant fiscal impacts. The next slide had an example that would provide an idea of magnitude.

Mr. Desai recognized that Ms. Lea was retiring after working for the division for 30 years.

Co-Chair Stedman thanked Ms. Lea for her service.

Ms. Lea thought one confusing piece of termination studies was the idea that it was a new requirement. She noted that termination studies had been part of the plan since its inception in 1961. She explained that the purpose of a termination study was to assess the change in retirement behavior that occurred with employee being removed from participation. She mentioned predicting costs and setting employer rates. Studies had shown that people did not generally retire at the first possible retirement date and worked for an additional four years. The funding was set up to be fully paid after the retirement date. Once an employer terminated a group, classification, or department; it changed the behavior of prospective retirees. There was a gap in funding between the anticipated date used by the actuary (to fully fund the benefit) and the actual date the member would retire.

Ms. Lea continued that as part of the termination process the state vested unvested employees in benefits. In the defined benefit plan an employee would be vested in the pension, whether the employee had five years of service or not. In the defined contribution plan the employee would be vested in the employer contributions. An employer still had to have ten years of service to be eligible the retiree health plan. When an employer terminated a group or classification, it created unfunded liability. Prior to 2008, each employer had its own contribution rate. In 2008, PERS was changed to a cost-share plan. An additional requirement was placed on employers to pay ongoing contributions to the plan based on past service costs of the terminated employees until the plan was fully funded in 2039.

Ms. Lea discussed the three components of costs of a termination study. There was the cost for an actuary to do the study, which was paid by the employer. There was the cost determined by whatever change in retirement behavior, and the cost of ongoing contributions to the plan.

Co-Chair Stedman stated that the following slide would provide a real example, and he had asked for the division

to use the Sitka Community Hospital, because it had just done a termination study.

[10:22:37 AM](#)

Mr. Worley spoke to slide 23, "Termination Costs - Recent Example":

Sitka Community Hospital

- Terminated from PERS on July 31, 2019
  - Purchased by SEARHC
  - City and Borough of Sitka responsible for annual past service cost payment until PERS is fully funded
  - Termination costs as of July 31, 2019 paid by Sitka Community Hospital
  - Continuing past service costs are paid by the CBS based on the past service cost percentage calculated each year during the annual actuarial valuation report
- Source: Buck - Trend rates used in the 6/30/18 valuation were updated from the 6/30/17 assumption 23

Mr. Worley explained that the initial termination cost to have the study done was in excess of \$700,000. The amount was determined based on work done with the hospital and had been paid to the state some months past. There was a continuing cost to the plan, which amounted to payroll and past service costs. Each year there was an evaluation report done, and actuaries determined annual cost and past service cost. For FY 21 the past service cost was 18.23 percent. For FY 22 the past service cost was estimated to be 16.6 percent.

Co-Chair Stedman asked if the annual cost and past service cost amounts would be discussed in dollars.

Mr. Worley recalled that the payment was approximately \$200,000 per year, and the payment would continue until 2039. He reminded that the City and Borough of Sitka was liable for the amount.

Co-Chair Stedman thought there was one more component to discuss.

Mr. Worley stated there was three costs: the cost of the study, the termination cost, and the annual payment of the salary times the past service cost (billed to the city).

Co-Chair Stedman thought the cost of the actuary varied by the size of the entity and number of people. He asked what kind of cost range a community could expect.

Mr. Worley estimated a community could expect a cost of \$2,000 to \$8,000, depending upon the size of the employer.

[10:27:11 AM](#)

Co-Chair von Imhof worried that termination studies might de-incentivize small communities from downsizing staff because it might be onerous. She asked if Ms. Lea had seen evidence of such.

Ms. Lea stated that the division heard what Co-Chair von Imhof mentioned frequently. The cost of the study and the termination liability did not appear to be a big issue with communities; but the ongoing contribution that was problematic. The division had heard back from cities and school districts that the cost was a problem area. She thought some had chosen not to take a downsizing approach because of the cost.

Co-Chair von Imhof asked if there were thoughts to help alleviate some of the concerns. She thought it was a perverse incentive to give local communities the flexibility to manage budgets and personnel. She used the example of school districts that were trying to free up money.

Co-Chair Stedman asked for assistance in differentiating between PERS and TRS in the termination study issue.

Ms. Lea noted that TRS did not have termination studies. Teachers were mandated into the plan and there was no option for school districts to remove groups of employees. Non-classified employees were part of the PERS plan.

Co-Chair Stedman thought the most important topic was the unfunded liability.

Senator Wilson asked if the state continued to assist in payments of non-state PERS employees after termination until PERS was fully funded.

Ms. Lea replied that when a non-state employee was terminated from participation, the employer was responsible

to pay the ongoing liability for the salary times the past service cost each year.

10:31:00 AM

Senator Hoffman wanted to ask about the additional funds in the retirement program such as the Supplemental Benefits System (SBS) and deferred compensation. He wondered how much money was being managed under the two programs. There was concern that the two funds were inaccessible to individuals until retirement. He thought it should be an individual's decision to access a deferred compensation fund. He thought it was a mistake to design the program in such a way and thought there would be individuals not participating in deferring income because of the lack of access.

Senator Hoffman pondered that the state did not know individuals' reasons for managing funds in a certain way. He thought that the administration should be looking at modifying the retirement plan submitted to the federal government to reassess whether deferred compensation would be accessible to individuals before retirement. He thought there was little incentive for state employees to participate in the deferred compensation program if the income was tied up for decades. He thought the decision on deferred comp was a mistake. He wanted the decision reevaluated.

Co-Chair Stedman asked for Mr. Desai to get back to Senator Hoffman regarding his question, as well as with information on additional federal requirements.

Senator Hoffman understood that most other states did not require deferred compensation be held by the state until retirement. He asked for information about what other states did with regards to deferred compensation.

10:35:22 AM

Ms. Lea stated that SBS and Deferred Compensation were tax qualified plans and were ruled by the IRS. She continued that SBS was a social security replacement plan, and the state had no flexibility for accessing funds prior to termination of employment. There was a required 60-day waiting period after termination. Under the Deferred Compensation plan, a 457b plan could not be accessed while

in service by any other means than by a loan. If a plan had a loan feature, it could loan money to a member that was required to be paid back. She reminded that a deferred compensation plan could not be accessed (per IRS rules) until termination of employment.

Senator Hoffman understood that other states had not included deferred compensation in retirement plans. He understood that an individual had to show extreme financial hardship to obtain the loans referenced by Ms. Lea.

Co-Chair Stedman asked Ms. Lea to discuss the availability of loans and the interest rate. He thought that the interest rate might go into one's own account upon repayment.

[10:38:04 AM](#)

Ms. Lea addressed Senator Hoffman's question. She noted that the plan currently had a hardship provision. The plan was a standard 457b plan, which was an IRS designation for a deferred compensation plan. The hardship provisions were part of the plan, and in order to receive funds it was required to meet federal definitions for an event or occurrence that was unforeseeable and for which there was no other funds. She noted that the hardship area of the plan was watched carefully by the IRS. The state's plan did not have a loan option, which could be instituted depending upon the philosophy towards the deferred compensation plan. From a retirement perspective, a loan option reduced the amount of money for distribution at retirement and was not favored by the state. The situation was different for deferred compensation plan members versus defined contribution plan members.

Ms. Lea noted that in conversation with other states and municipalities, it was found that loan programs were expensive and required tracking and charging of interest. She was happy to provide the information on a potential loan program for the committee to consider.

Senator Hoffman strongly opined that the decision to defer income should be left to the employee. He did not think the government should be concerned with employee management of deferred compensation funds that were voluntarily contributed. He thought there was very little incentive for people to put funds into a deferred compensation program.

He thought that the state had made it hard for individuals to participate in a deferred compensation program.

[10:42:32 AM](#)

Co-Chair Stedman reiterated the request for information about the aggregate balance and other information about the deferred compensation program. He recalled that if there was a loan provision that was used incorrectly it would be possible for the IRS to disqualify the whole plan. He thought there were strings attached to the loan program. He suggested that the division provide research on the programs and exposure to the employer if the option was left to run amok.

Senator Wielechowski asked if employees in the defined contribution tier were subject to the federal windfall elimination provision that lessened social security benefits the employee might have.

Ms. Lea answered "yes."

Co-Chair Stedman thought social security was a whole different topic. He asked Ms. Lea to provide the IRS regulations on the topic.

Senator Wielechowski thought a person had to have 30 years accrued benefits to qualify. He thought even a couple of years in a defined contribution program would lessen a person's social security benefit. He asked if there had been discussion about going back to social security in the state.

Ms. Lea stated there had been discussion from time to time regarding going back to social security, but it would require a referendum vote by the employees as SBS was chosen in lieu of social security by such a vote. She stated that if a person had time with a defined contribution plan, the earnings and length of time would dictate any offset to a social security benefit.

[10:45:49 AM](#)

Senator Bishop discussed termination studies through the example of an employee the City of Galena. He described a hypothetical scenario in which a person was a Tier 2 PERS employee in the defined benefit plan. The person left

Galena to work for the North Star Borough in Fairbanks. He asked if Galena would still be paying on behalf of the person for a termination study.

Ms. Lea stated that the City of Galena would continue to pay the ongoing contributions based on the salary from Galena until the past service was completed.

Co-Chair Stedman pointed out that the termination was different than when an employee quit and moved to another employer. He thought Senator Bishop was asking if someone changed employment, it was different than if the city terminated the participation in PERS.

Ms. Lea stated that if an employee terminated employment with one employer and moved to another, each employer paid their share in the form of the 22 percent for the benefits accrued. In the cost-share plan, all employers paid 22 percent.

Senator Bishop did not think the situation was fair to the City of Galena. He thought it appeared as though the employee was double-dipping, since the employee was still in the system and contributing.

Ms. Lea stated that an employee had accrued service earned through the first employer and would anticipate to receive payments based on the years of service accrued with the first employer. She asserted that the fact that the employee was still making contributions did not negate the liability for the years served with the first employer. The new employer would begin making contributions on the employee's behalf for service starting at the time of hire.

[10:49:00 AM](#)

Senator Wielechowski asked if Ms. Lea was aware of any states in which in public employees did not have a defined benefit plan and also did not get social security.

Ms. Lea stated that there were many TRS teachers in other states that were not in social security like teachers in Alaska. Some, particularly universities, had defined contribution plans and were neither in social security nor a replacement plan.

Co-Chair Stedman understood that teachers under TRS could vote to opt out of the program and go back into social security.

Ms. Lea affirmed that with a referendum vote, teachers could choose to go back into social security. The change could be done on a district by district basis.

Senator Wielechowski asked if there were public employees other than teachers in the country that did not have a defined benefit plan or social security.

Co-Chair Stedman asked Ms. Lea to provide the information at a later time. He thought it was a good to have some comparative data. He had heard that there had been some participants in which a termination study had exceeded the value of the community due to the small size.

Co-Chair Stedman shared a concern that municipalities had not closed out departments to shed liability back to the state. The legislature had tried to figure out how to deal with the issue of liability.

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

#  
ADJOURNMENT  
[10:54:01 AM](#)

The meeting was adjourned at 10:54 a.m.