

HOUSE FINANCE COMMITTEE
January 30, 2024
1:34 p.m.

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CALL TO ORDER

Co-Chair Johnson called the House Finance Committee meeting to order at 1:34 p.m.

MEMBERS PRESENT

Representative Bryce Edgmon, Co-Chair
Representative Neal Foster, Co-Chair
Representative DeLena Johnson, Co-Chair
Representative Julie Coulombe
Representative Mike Cronk
Representative Alyse Galvin
Representative Sara Hannan
Representative Andy Josephson
Representative Dan Ortiz
Representative Will Stapp
Representative Frank Tomaszewski

MEMBERS ABSENT

None

ALSO PRESENT

Ajay Desai, Director, Division of Retirement and Benefits, Department of Administration; Kevin Worley, Chief Financial Officer, Division of Retirement and Benefits, Department of Administration; Kathy Lea, Chief Pension Officer, Division of Retirement and Benefits, Department of Administration.

PRESENT VIA TELECONFERENCE

David Kershner, Consulting Actuary, Buck Global LLC.

SUMMARY

PRESENTATION: ALASKA PUBLIC EMPLOYEES' RETIREMENT SYSTEM AND TEACHERS' RETIREMENT SYSTEM UPDATE

Co-Chair Johnson reviewed the meeting agenda.

^PRESENTATION: ALASKA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
and TEACHERS' RETIREMENT SYSTEM UPDATE

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AJAY DESAI, DIRECTOR, DIVISION OF RETIREMENT AND BENEFITS, DEPARTMENT OF ADMINISTRATION, introduced himself.

KEVIN WORLEY, CHIEF FINANCIAL OFFICER, DIVISION OF RETIREMENT AND BENEFITS, DEPARTMENT OF ADMINISTRATION, introduced himself.

KATHY LEA, CHIEF PENSION OFFICER, DIVISION OF RETIREMENT and BENEFITS, DEPARTMENT OF ADMINISTRATION, introduced herself.

Mr. Desai introduced the PowerPoint presentation "State of Alaska Department of Administration Division of Retirement and Benefits Presentation to the House Finance Committee" dated January 30, 2024 (copy on file). He began on slide 2 which included the organizational chart for the Public Employees' Retirement System (PERS) and the Teachers' Retirement System (TRS). He relayed that the Alaska Retirement Management Board (ARMB) worked with the Department of Administration's (DOA) Treasury Division and the Department of Revenue's (DOR) Division of Retirement and Benefits (DRB) to manage the funds for both systems.

Mr. Worley continued on slide 3 which showed statistics on the membership of PERS and TRS as of June 30, 2023. Active members made up about 25 percent of the PERS Defined Benefit (DB) plans whereas about 75 percent of members were active in the Defined Contribution (DC) plans. For TRS, about 31 percent of DB members were active and 69 percent of DC members were active. From the creation of the DC plans, it took about ten years to reach an evenly split membership between the DB and DC plans. About 50 percent of members were part of the DB plans and about 50 percent were part of the DC plans, with the DC membership scaling up as the DB plans had been closed.

Representative Tomaszewski noted that Tier IV was not listed on the slide.

Mr. Worley responded that Tier IV was also known as the DC plan and was listed on the bottom half of the slide. He

explained that Tier I through Tier III were listed under the DB section on the slide.

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Representative Stapp asked if DRB had considered looking at employees active in Tier III who had not vested but still had the option to return to the program and vest into it. He understood there was a group of employees that did not vest in the retirement system. He asked if there was an estimate of the number of Tier III employees who had not yet vested in the plan.

Mr. Desai responded that the concept was also known as the Metcalfe case, which had been brought forth a few years prior. There was a law passed in 2010 that mandated any members in the DB priority tiers who cashed out of the system and returned to state employment later would be hired under the DC plan. The Metcalfe case reversed the law and made it possible for employees to buy back into the same tier if they returned to state employment. He clarified that any members who left employment under Tier I through Tier III for PERS or Tier I and Tier II for TRS could return to the same tier if the employee was rehired.

Representative Stapp asked if there was an estimate as to how many employees could potentially return to employment and resume benefits under the same DB tier.

Mr. Desai responded that there were about 86,000 impacted members.

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Representative Josephson thought it was important for the committee to know how many employees had actually returned to state employment and vested back into the system.

Mr. Desai replied that he would return to the committee with the information on how many employees had returned. He would also provide the number of employees that decided to convert to a DB plan from a DC plan.

Co-Chair Johnson suggested that they set a date for the follow up. She asked if Mr. Desai could provide the information by the following week.

Mr. Desai responded in the affirmative.

Representative Hannan understood that the 86,000 figure referred to the members who had cashed out of the system. She asked if the 5,554 inactive but vested members shown on the chart on slide 3 were included in the 86,000 figure.

Mr. Desai responded that the 5,554 figure referred to the inactive but vested members who had not withdrawn from the system. The members were still part of the system and were therefore not included in the 86,000 figure.

Representative Hannan asked if the 5,554 inactive but vested members would be added to the 86,000 members who had cashed out but could return for a total of over 91,000 impacted members.

Mr. Desai responded that the 5,554 inactive but vested members were not subject to the Metcalfe ruling. The case only impacted members who had left the plan and wanted to reinvest.

Co-Chair Johnson thought that the presentation would generate many questions. She might set some benchmarks if the committee was getting behind schedule.

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Mr. Worley continued on slide 4, which included information on the returns for PERS and TRS for FY 22 and FY 23. The assumed actuarial earnings rate for both PERS and TRS for both years was 7.25 percent. The actual rate of return for the assets was negative 6 percent for both accounts in FY 22 and a positive 7.6 percent in FY 23. The division also evaluated the actuarial value of assets which was based on smoothing over a five-year period. For funding purposes, the division used the actuarial value of assets because returns could vary dramatically from year-to-year.

Representative Stapp asked how the 7.25 rate was determined.

Mr. Worley replied that the rate was approved by ARMB and the actuarial assumptions were reviewed every four years. Two actuaries worked on determining the rates: the first actuary worked for both DOR and DRB, and the review actuary

worked for ARMB only. The board worked with an investment advisor and 7.25 was settled on after the final evaluation.

Representative Stapp asked if the rate of return was revised upwards or downwards after the last review process.

Mr. Worley responded that the rate was reduced from 7.38 percent to 7.25 percent.

Mr. Worley advanced to slide 5. There was a DB pension trust and a DB health care trust. The slide was just for informational purposes and he did not want to spend a substantial amount of time on it to avoid any confusion.

Mr. Worley continued on slide 6, which detailed the funded status for the DB pension trust for both PERS and TRS. The June 2023 valuation report was presently being drafted and the division would be going over the reports in March of 2024. The actuarial accrued liability for 2023 based on the actuarial value of assets (AVA) was 67 percent funded for PERS and 76.8 percent funded for TRS. The funding had been relatively flat for the last few years for a variety of reasons; for example, the valuation report for June of 2021 was 7.38 percent and the reports for 2022 and 2023 were valued at 7.25 percent, which would cause the liability to increase. He reiterated that the 30 percent rate of return in 2021 was an anomaly. He highlighted lines A through D on the slide which were the most important line items when considering the budget. There was a slight increase in unfunded liability from FY 22 to FY 23 partly because the liabilities had increased, health care costs had increased, and inflation had increased. Assets did not increase as much as liabilities.

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Representative Josephson recalled that around 2013, the legislature spread \$3 billion between PERS and TRS in an attempt to refinance the system and decrease the outlay from around \$700 million to less than \$350 million. He asked if the attempted refinancing had been a factor in the pace at which the unfunded liability was being retired.

Mr. Worley replied that the event occurred in FY 15. He indicated that the division had graphs that showed the impact of the contributions that he could distribute to the committee. The refinancing began the 25-year amortization

payoff of the liability. The board modified the single layer 25-year amortization and it became a layered amortization. He explained that 2018 became the first layer and every subsequent year became an additional 25-year period.

Representative Stapp clarified that the funds had positive performance in the prior year because most of the DB had an inflationary adjustment due to high inflationary pressure at the federal level, which caused capital outflows to increase. He asked if it would be fair to say that unfunded liability had increased because the state had to pay more money in adjustments.

Mr. Worley responded that inflation was high for the post-retirement pension adjustment.

Ms. Lea responded that the post-retirement pension adjustment was calculated based on age. Individuals under the age of 65 received an adjustment that was 50 percent of the increase and individuals over 65 received an adjustment that was 75 percent of the increase.

Mr. Worley added that if the actual figures were higher than the figures projected by the actuaries, liabilities would increase and would become an actuarial loss to the plan.

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Mr. Worley continued on slide 7 which detailed the funded status of the PERS and TRS health care trust from FY 21 through FY 23. He reiterated that the information for FY 23 was still in draft mode. The red numbers on the slide referred to the areas in which the accounts were overfunded. He relayed that PERS was about 130 percent funded in FY 23 and TRS was about 135 percent funded. Health care inflation was slightly higher than the actuaries had expected, which increased the accrued liability.

Representative Josephson noted that one of the concerns in 2006 when DB plans closed was the cost of health care. He relayed that the concern remained due to the limitations of health reimbursable savings accounts. He asked why the health care portion of the trust was robust and overfunded. He stated that legislators were "steering away" from

reforming the health care portion of the trust. He asked why health care benefits were not more generous given the returns.

Mr. Worley noted that the health care trust was underfunded in the early 2000s. The division had to split an amount of money between a pension and a health care trust in around 2008. He explained that the division looked at ways to improve cost containment within the health care trust in around 2015 and one of the strategies was the Employer Group Waiver Program (EGWP). The division was able to join EGWP which reduced the cost of health care for retirees. There was a slide later on in the presentation that discussed the program in more detail. The program was paramount in the transformation of the trust from underfunded to overfunded.

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Mr. Desai continued on slide 8 which showed the funded ratio for the PERS pension and health care. The blue bar on the graph on the slide showed the funded ratio of the pension and the orange bar showed the funded ratio of health care. The orange bar was over 100 percent and the blue bar was around 67 percent in 2023.

Mr. Desai moved to slide 9, which showed the funded ratio for TRS pension and health care. The green bar on the graph on the slide showed the funded ratio of the pension and the orange bar showed the funded ratio of health care.

Mr. Desai advanced to slide 10, which showed similar information as slide 8 and 9 but the information was combined at a system level. The blue bar represented the funded ratio for PERS and the green bar represented the funded ratio for TRS. If the systems were to be combined, PERS would be funded at 85.5 percent and TRS would be funded at 91.2 percent for 2023.

Mr. Worley emphasized that the slide was intended for informational purposes only and the two trusts could not be combined.

Mr. Desai moved to slide 11 which showed the correlation between actual rate of return and funded ratio. The table showed how the funded ratio was impacted when there were negative returns compared to expected rates of return.

Specifically for the earlier years starting in 2000, the discrepancy between expected returns and actual returns was more extreme. In 2008, the expected return was about 8.25 percent under PERS and the actual rate of return was negative 3.13 percent. He indicated that PERS was funded at 69.5 percent in 2008 but in 2009, the number dropped to 61.8 percent. He reiterated that the funded ratio was directly impacted when the expected returns were not met. He highlighted that the 30-year average rate of return was 7.55 percent and 7.6 percent for TRS.

Representative Stapp remarked that the actual rate of return in 2023 was 100 basis points off from 2000. He asked why all of the revisions were trending down. He asked what it was about the methodology that was causing the decline.

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DAVID KERSHNER, CONSULTING ACTUARY, BUCK GLOBAL LLC, (via teleconference), responded that the 7.25 assumed actuarial earnings rate was the long-term expected rate of return and was set every four years through an experience study in which Buck evaluated all of the assumptions. The rate was set based on forward-looking expectations in terms of equity returns, bond yields, and the asset allocation set by DOR in collaboration with ARMB. The combination of asset allocation and the general decline in forward-looking expected returns, particularly for equity, contributed to the decline in the expected return assumption.

Representative Stapp understood that expectations had been declining for over 20 years. He thought that if expectations were routinely being exceeded by performance, the expectations should be revised upwards. He thought that the expectations were consistently excessively generous.

Mr. Kershner responded that the decline had happened but it was not intentional. The rate was simply based on the changing environment and future expected returns had been declining over the last ten years, which was the reason for the declining rate.

Mr. Worley added that similar plans across the nation were all in decline.

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Mr. Desai advanced to slide 12 which detailed the unfunded actuarial liability for PERS. The blue bars referring to the pension were above zero and the orange bars referring to health care were below zero in 2023. There was unfunded liability for the pension system within PERS and the orange bar being below zero was encouraging.

Mr. Desai continued to slide 13, which detailed the unfunded actuarial liability for TRS. The green bars referring to the pension were above zero and the orange bars referring to health care were below zero in 2023.

Mr. Desai moved to slide 14, which combined pension and health care plans within PERS and TRS for informational purposes only. He highlighted that the total unfunded liability in 2013 was at about \$12.4 billion, \$1 billion of which was under PERS and \$2 billion was under TRS. The unfunded liability decreased dramatically from 2013 to 2015.

Mr. Desai advanced to slide 15, which showed the history of the additional state contributions, which totaled to about \$8.35 billion as of 2024. Any difference between the TRS and PERS contributions were paid by the state as an additional contribution.

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Representative Josephson understood that the amortization reform came from HB 119 in 2015. He noted that it was agreed upon that a person would pay off a 15-year mortgage on a house faster than a 30-year mortgage. He asked if the state was following the opposite strategy for the amortization. He wondered if the state would pay more due to the reform and asked what the impact of the reform was on retiring the DB plan.

Mr. Desai responded that in 2014, the target to fund both systems by 2039 was established in statute. The cost was used to determine the "stretch out" of the numbers. The future contributions could be reduced if present day contributions were increased.

Mr. Desai continued on slide 16 which detailed the additional state contributions that were projected based on the most recent valuation. From 2025 up until 2039, DRB expected that there would be about \$4.4 billion in

additional contributions. The systems were expected to be fully funded by 2039.

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Representative Stapp asked if a 2.5 percent inflationary target was assumed in the actuarial analysis through 2039.

Mr. Kershner responded in the affirmative and clarified that Buck's long-term inflation assumption was 2.5 percent.

Representative Stapp asked if it could be more expensive if actual performance was in opposition to the 2.5 percent inflationary adjustment.

Mr. Kershner responded in the affirmative. The 25-year amortization of the unfunded liability that was established in 2014 was modified slightly by ARMB in 2018. Rather than having one single "mortgage," there were currently a number of "little mortgages" which were all funded over 25 years. When there was high inflation that had increased the liability beyond what was expected because the assumption was 2.5 percent, the losses to the plan were funded in the future over the course of 25 years.

Mr. Worley added that in FY 25, the projected \$59.1 million in additional state contributions to PERS and \$125.3 million to TRS were presently in the operating bill.

Co-Chair Johnson asked how the additional contribution in 2015 changed the payments into the fund.

Mr. Worley responded that there was \$3 billion in additional contributions in 2015: \$1 billion in PERS and \$2 billion to TRS. The contribution reset the amortization period and began the 25-year time frame over again, changed the goal for the accounts to be fully funded to 2039, and changed the methodology through which the plans were funded. Prior to the \$3 billion infusion, the funding was based on a "level dollar" contribution, which was to increase up to \$1 billion per year between the two systems. After the infusion, the funding was set to be a level percentage of pay and the actuary would compute an employer contribution rate and apply it against the payrolls during the fiscal year.

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Co-Chair Johnson asked if the change would be executed in the same manner if it were to happen today. She asked how the particulars were determined.

Mr. Worley asked for clarification on which particulars Co-Chair Johnson would like to know more about.

Co-Chair Johnson relayed that she understood how the contributions were determined. She would follow up with her question outside of the meeting.

Mr. Worley would be happy to provide a response.

Representative Coulombe asked Mr. Worley to speak to the meaning of "without health care normal cost contributions" stated at the bottom of slide 16. She asked if it meant that the chart on the slide would remain without contributions.

Mr. Desai responded in the affirmative and added that the following slide would provide more detail.

Mr. Worley added that the schedule assumed that there would be zero contributions to health care due to overfunding.

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Representative Galvin referred to slide 7 and noted that all of the funds were listed at 125 percent funded in 2021. She asked what the industry standard was and what the goal of the department was.

Mr. Desai responded that the goal was to be funded at 100 percent and remain at 100 percent. The goal for the state to be funded at 100 percent by 2039. Plans funded at 90 percent and above were considered healthy and plans funded at 80 percent were considered to be in the "green zone."

Representative Galvin explained that she was referring to the health care portion specifically. She understood that the goal was to be funded at 100 percent by 2039 but health care was overfunded. She was not sure what the industry standard was and wondered if it was normal for a health care plan to be overfunded.

Mr. Worley replied that one of the things to consider when speaking about health care was the issue of the cost of claims. The claims in 2023 were higher than expected and the high price decreased the level of overfunding. The EGWP costs were also decreasing and revenue was expected to be lower than it had been in recent years. He reiterated that ARMB was in the process of determining when money should be reallocated to the health care trust through normal cost contributions.

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Representative Stapp thought that the idea that health care was overfunded came from a naïve understanding of the volatility of claims accounts. He relayed that Premera BlueCross BlueShield was the largest individual insurer in the state and it recently suffered a \$26 million operational loss on its claims alone. He remarked that from an actuarial standpoint, health care was difficult to predict, cost drivers were increasing, and access was challenging. He argued that although health care might be overfunded in the current day, it could be underfunded tomorrow.

Co-Chair Johnson asked if Representative Stapp had a question.

Representative Stapp relayed that he had a comment. He wanted to speak to the volatility of attempting to amortize health care claims, especially as the population grew older. He did not think anyone at Premera would have predicted a \$26 million actuarial loss due to the unpredictability of health care.

Mr. Worley added that the division looked at the cost of health care claims on an annual basis. There were slides later in the presentation that discussed the projected increase in claims costs over the next 50 years.

Representative Hannan presumed that dental and behavioral health benefits were within the health care benefits. She asked whether ARMB could adjust which benefits were available or if the available benefits were set by a different entity. She indicated that suicide rates had increased in older Alaskans, but behavioral health benefits were limited.

Mr. Desai responded that the division worked with Buck Global consultants as well as the Retiree Health Plan Advisory Board (RHPAB) to study health care benefits and it was responsible for the benefit structure.

Representative Hannan noted that the dental benefit was not as generous as the health care benefit, but there was a strong link between dental health and cardiac health. She asked if the limited benefit could be addressed by allowing increased dental screenings to identify potential cardiac risks and lower the cost of cardiac claims. She wondered if consultants conducted similar work as in her example about the dental benefit.

Mr. Desai responded in the affirmative. He relayed that Alaska's dental benefits were behind the rest of the country. He reiterated that the division worked closely with the consultants and RHPAB. He emphasized the importance of exerting caution when considering adding or removing benefits to ensure that the funds were actuarially sound and adhering to statute. He noted that the division evaluated the benefits quarterly and would be meeting with Aetna, Buck, and ARMB in the upcoming week to craft actuarial recommendations. The board would then make recommendations to the commissioner of DOA and then the benefits would be implemented. Many benefits had changed significantly over the past six years. Health care was presently overfunded by a high percentage, but it could change tomorrow. In the prior year, the division had received one single claim that was over \$2 million, which changed the cost analysis. The division was responsible for ensuring that all retirees and individuals who were currently active would be able to receive benefits in the future.

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Mr. Worley added that retirees had an additional dental, vision, and audio plan and a long-term care plan. The plans were funded by the retirees and were not funded through the retiree health program.

Mr. Worley continued on slide 17 which detailed the FY 25 contribution rates. The FY 25 rate was adopted by the board in 2023. The first column in the chart under FY 25 preliminary included the rates that were initially prepared by Buck. He relayed that Buck projected a 28.39 percent

preliminary rate for PERS and 30.62 percent for TRS. The annual contribution that would be required through payroll for the PERS DB health plan was \$47.8 million; however, the board determined that it would be better to have a zero percent contribution rate to a plan that was already overfunded. The board adopted a rate of zero percent, which lowered the total PERS contribution rate to 26.76 percent. Due to the zero percent contribution rate, the state saved \$47.8 million in contributions. The overall PERS request was \$59.1 million. When the board adopted the zero percent contribution rate, it included a zero fiscal impact cost for both PERS and TRS. Originally, \$16.2 million would have gone to the health trust but since the board adopted a zero percent contribution rate, \$0 would be going into the trust. He emphasized that the returns on the invested assets were 7.6 percent even though there would be no additional funds allocated into the trust. The bottom line was that there was a total savings of \$64 million due to the adoption of the zero percent rate.

Co-Chair Johnson asked whether the municipalities contributed at a 22 percent rate.

Mr. Worley responded in the affirmative.

Co-Chair Johnson noted that under the TRS section, there was an additional state contribution listed. She asked what the purpose was of the additional state contribution.

Mr. Worley replied that the contribution was from the school districts, which were required to pay 12.56 percent on all eligible TRS employees. The state adopted 28.59 percent as the contribution rate for TRS and the non-state employer contribution rate of 12.56 percent was then subtracted from the state rate, which elicited a 16.03 percent additional state contribution rate.

Co-Chair Johnson asked if the 12.56 percent was a negotiated rate.

Mr. Worley responded that the rate was established in statute as the required rate for TRS employers.

Co-Chair Johnson asked why 12.56 percent was the chosen rate.

Mr. Worley responded that he was not familiar with the negotiations.

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Mr. Worley continued on slide 18 and reiterated that the health care trusts were overfunded. The chart on the slide showed the projected funding level of the health care trusts for both PERS and TRS from FY 24 through FY 29. He explained that Buck composed the annual actuarial evaluation report for PERS and TRS. One of the requests from the board was to determine what the funded status of the trusts would be if employers continued to pay the normal cost for health care and what the status would be if zero percent was adopted as the contribution rate. If employers continued to pay the normal cost, the funded level of PERS would continue increasing from 129.6 percent in 2024 to 179.7 percent by 2039. The board wanted to see what the impact of a zero percent normal cost contribution rate would be from 2024 through 2039. He relayed that PERS would increase from 129.6 percent funded in 2024 to 170.9 percent in 2039. The increase would be due to claims costs being paid, annual increases to health care, and the health care trust earning a 7.25 percent return. The TRS projects were similar with an increase from 135.5 percent funded in 2024 to 196.9 percent with a normal cost contribution and 189.2 percent without a normal cost contribution.

Representative Josephson asked what a comparable slide would look like on the non-health care side of the ledger. He asked if it would simply show numbers rising towards 100 percent.

Mr. Worley assumed that Representative Josephson was asking about the pension trust. He responded that the trust would be fully funded on the pension side by 2039 if the funding plan in place were to be followed. The expectation was that the trust would start at about 60 percent to 70 percent funded and would increase to 100 percent by 2039. Some of the viability layers would need to be paid after 2039, but the overall goal was to reach 100 percent by 2039.

Representative Josephson agreed that there were many variables on the health care side and that people would be receiving health benefits after 2039. He asked what the state did with the excess funding. He understood that

overfunded meant there was more cash in the system than was used and he wondered what happened to the excess cash.

Mr. Worley responded that the money belonged to the system and the health care trust. The division had examined the 0 percent contribution rate to avoid adding money to a fund that was already overfunded. He emphasized that the division could not promise benefits and then pull back the benefits at a later date as the benefits would contribute to liability. The division expected that EGWP would have a negative impact on the trust. He reiterated that the money had to stay in the trust and could not be used elsewhere.

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Mr. Desai continued to slide 19 which showed the FY 25 contribution rates for DB plans. The first column showed the employee contribution under PERS. Peace officers and firefighters received a 7.5 percent contribution rate, school district alternative option employees received a 9.6 percent rate, and all other PERS employees received a 6.75 rate. Employer contributions would be at 22 percent and were capped in statute; however, the total required contribution for FY 25 was 26.76 percent, which meant there was a discrepancy between the capped rate and the required rate. The difference of 4.76 percent represented the additional state contribution. The total employee contributions for TRS were 8.65, the employer rate was 16.03, and the total required contribution was 28.59, making additional state contributions 16.03 percent.

Mr. Desai advanced to slide 20 which showed similar information for the FY 25 contribution rates for DC plans. The employee contributions were 8 percent for both PERS and TRS, employer contributions were 5 percent for PERS and 7 percent for TRS, the health care retiree major medical plan contributions were 0.83 percent for PERS and 0.68 percent for TRS, peace officer or firefighter occupational death and disability contributions for PERS were 0.69 percent and not applicable for TRS, and all other occupational death and disability contributions were 0.24 percent for PERS and 0.08 percent for TRS. The Health Reimbursement Account (HRA) under PERS was calculated as a flat dollar amount on an annual basis and was 3 percent of all PERS and TRS average annual compensation rates. After all contributions on behalf of the employee were made, 8 percent was allocated to the DB account balance for PERS and TRS

employees. The remaining employer contribution was 22 percent for PERS and 12.56 for TRS and went to DB plans as unfunded liability.

Representative Stapp understood that excess contributions would go to unfunded liability for TRS. He asked how equity was built in retirement accounts with a 12.56 contribution rate. He asked what the standard salary percentage was in terms of monetization.

Mr. Desai responded that the rule of thumb was that a retiree should have at least two-thirds of their most recent salary upon retirement. When an employee took home a paycheck, there were many contributions taken from the check such as health care and taxes. The real paycheck came out to be about two-thirds of an actual salary. He indicated that the two-thirds number was rounded up to 70 percent today. When looking at retirement income compared to most recent salary, there should be an equivalent of nearly 70 percent.

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Representative Stapp asked if the division could meet its goals with a 7 percent employer match.

Mr. Desai responded that the division conducted a study in the prior year comparing the benefits based on a 7 percent employer match. He explained that the results depended on how the funds were invested and how long the funds were invested. The success of the DC plan was based upon the length of time the money was kept in the plan. If an employee were to cash out immediately after retirement, the money received would be less than if the employee were to wait for the money to increase in value due to compound interest.

Representative Stapp thought there was a missing piece. He asked for more detail on the Supplemental Benefits Annuity (SBS) plan which he understood was supported by PERS.

Ms. Lea responded that there were four types of supplemental plans in the state. The SBS plan was for state employees and participating political subdivisions. The plan was a 6.1 match from both the employee and the employer. Another plan was the Deferred Compensation Plan (DCP) which was for state employees and included employee

contributions. The plan had the capability of including an employer match, but presently only had employee contributions. There were also 403(b) plans, which were plans for teachers and were similar to a 401k. There were also some employers participating in social security. She remarked that funding retirement traditionally looked like a "three legged stool" as included a retirement portion, a supplemental savings portion, and a social security or social security replacement portion.

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Representative Josephson asked for a description of the way in which the excess contribution for younger workers made on behalf of political subdivisions was calculated. He thought that the state would calculate it based on the head count of all employees. He understood that even the younger employees in DB plans were contributing to a DB liability. If all money was competing with all other money, opportunities for economic growth within a DC plan would be hampered by the fact that the younger cohort would be contributing to the unfunded liability. He wondered if the system was placing the burden of the previous liability on the younger cohort.

Ms. Lea replied that when the DC plan was created, the total unfunded liability was considered. She relayed that the rates varied from employer to employer depending on the number of participants and the number of retirees. The past actions of some employers made for higher liability for some and lower for others. The negotiations resulted in employers paying 22 percent on both DB and DC plans because it was a flat and budgetable rate. Employers paid an amount above what was necessary for DC employees. She emphasized that DC employees would not shoulder any of the unfunded liability, but the employer would continue to pay the debt that had accrued on the DB plans.

Representative Josephson commented that there were two contesting theories: either the previous legacy plans were burdensome and underfunded, or DB opportunities for the younger cohort involved a loss of opportunity because government funding was burdened by the previous plan. He thought that it seemed as though the "sins of the past" had been placed on future generations.

Ms. Lea agreed that it was in a sense what happened because the debt was accrued and was owed by employers. The state agreed to pay a portion of the debt on the behalf of the employers, but the debt impacted the ability of the employer to direct funds in other areas. The population in every participating city in the state felt the impacts of the debt.

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Representative Stapp understood that in the event that the unfunded liability was paid off, the 22 percent employer contribution would be allocated to an employee's DC plan. He asked if he was correct in his understanding.

Mr. Desai responded in the negative.

Representative Stapp asked what happened to the employer contribution if the unfunded liability was paid off.

Mr. Desai replied that if the 22 percent cap was not in place, the actuarial contribution rate for the DB plan would be 26.76, as seen on slide 19. The remainder of the entire cost was derived by subtracting the 22 percent cap from 26.76 percent and would be funded by the employer. A portion of the money from the 22 percent cap was allocated to the unfunded liability. If the 22 percent cap was not in place, the DC plan would be offered in place of the cap and there would be no additional contribution if there was no unfunded liability. Since there was an unfunded liability in the DB plan, the employer would be responsible for paying the debts. The employer would pay up to 22 percent and the remainder of the money was paid by the additional state contributions. When the plans were fully funded in 2039 and there was no more unfunded liability, the cap would no longer be in place and the actuarial rate would drop from 12.6 percent to around 12 percent. As long as the expected returns were met, the plans would be 100 percent funded and all promises would be met and an unfunded benefit could be paid. He agreed that it was confusing. Due to the cost share plan that was established in 2008, the state was taking responsibility for paying the debts. The benefits under DC plans would be independently going to the marketplace and the returns were independent from DB plans.

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Representative Hannan asked Ms. Lea how many subdivision units or individuals in the state were eligible for social security. She was aware that TRS employees were not eligible and most state employees also were not eligible. She wondered how many employees in the public pension sector in the state were eligible.

Ms. Lea would follow up with the information. Out of all participating employers in PERS, there were 75 that did not have social security or SBS.

Representative Hannan asked how many total employers were in PERS.

Ms. Lea responded that there were 150.

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Mr. Desai moved to slide 21 and detailed a review chart of contribution rates of PERS and TRS. The blue line on the PERS chart showed the history of the employer rate capped at 22 percent and the orange line showed the actuarial rate. The gap between 22 percent and the actuarial rate was the amount paid by the state. The state had paid about \$8.4 billion towards the unfunded liability. The blue line on the TRS chart represented a 12.56 percent cap, the orange line represented the actuarial rate, and the gap between the two was the state contribution. The state as an employer started paying the entire actuarial cost for PERS a few years prior, therefore the gap on the chart was only applicable to non-state employees.

Mr. Desai continued on slide 22 which included a graph showing the projected pension benefit recipients. There were an estimated 54,600 in 2025: 40,000 from PERS and 14,000 from TRS. In 2023, the total number of recipients was projected to peak at 58,000.

Mr. Desai continued on slide 23, which showed similar information as slide 22 but it represented the projected pension benefits payments in dollars. In 2025, the payment was projected to be \$1.7 billion: \$1.1 billion to PERS and \$600 million to TRS. The payment was projected to peak in 2037 with the payment totaling \$2.1 billion.

Mr. Desai continued to slide 24 and explained that the AlaskaCare EGWP was a group Medicare Part D prescription

drug plan option. The plan provided a direct subsidy and was considered when calculating the Other Post-Employment Benefits (OPEB) liability under both the Governmental Accounting Standards Board (GASB) and the Financial Accounting Standards Board (FASB) accounting schemes. The implementation of EGWP reduced health care liabilities by about \$959 million, which resulted in lower projected liabilities, lower projected contribution rates, and lower projected additional state contributions. He relayed that it had proved to be far more successful than the previous option, the Retiree Drug Subsidy (RDS).

Mr. Desai advanced to slide 25 which showed the annual savings from the EGWP subsidy. The original annual savings estimate in 2020 was about \$60 million with a net of \$40 million, which meant that the department would be saving about \$20 million from RDS. In 2021 through 2023, the estimated savings amount was increasing, with a total of \$60 million in savings estimated in 2023.

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Representative Stapp asked if Mr. Desai had considered looking at cost projections pending some changes in legislation. He noted that there was currently proposed legislation in the state that would make significant changes to prescription drugs.

Mr. Worley replied that it was part of the actuarial process. He relayed that Buck's health actuary was responsible for looking at the cost projections while considering potential changes such as the passage of new legislation. He assured Representative Stapp that DRB was examining the potential impact of the changes to subsidies at the division's next meeting.

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Mr. Worley continued on slide 26 which detailed one of the actuarial assumptions applied to health care costs. The slide included a chart tracking the health care cost trend rates. The division had projected different cost increments from FY 23 through FY 50. Different cost increments were projected for beneficiaries under the age of 65 and those over the age of 65. The actuaries used the chart when projecting costs in the future and projected liability on a specific date. The most recent valuation was on June 30,

2023, and the chart would be used to project cost trends. The costs were examined annually, but not necessarily changed annually.

Co-Chair Johnson understood that past errors due to the state's past actuary were responsible for the unfunded liability. She asked for more details on the process.

Mr. Desai directed attention to slide 11 which showed the correlation between the insurance in the marketplace and the actual funded ratio. One of the most important factors in determining unfunded liability was demographic, which was projected every four years to determine whether there were any significant changes. He emphasized that demographic assumptions were usually highly accurate. He explained that the one variable it was not possible to control was the changes between the economy 30 years ago and the economy in the present day. The global economy impacted everything and not just the pension plans. The division expected a return of 7.25 for PERS in 2022 but received a negative 4.08 percent return, which meant there was a loss of approximately 11.5 percent. The uncertainty in the marketplace impacted the DB plans significantly. He added that the market was also more global than it was 30 years prior.

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Mr. Desai advanced to slide 27 which showed the process timeline to determine employer contributions and additional state contributions. The actuary used the 2022 valuations, 2023 assets with the actual rate of return, and 2024 assets with the projected rate of return of 7.25 percent to determine the FY 24 employer contributions and additional state contributions. He concluded the presentation.

Representative Josephson remarked that the report released by ARMB in October of 2023 stated that the board would recommend a closure of the Empower Retirement System, which was the state's account manager. He noted that there was an individual present in the capitol building who led the closure effort in the current year. He asked what the current status was of the SBS Empower funds.

Mr. Desai replied that Callan conducted a specific study on the Empower management. He relayed that the management of the accounts was only successful when the participants were

providing the information that allowed the manager to see the complete picture of the participants' portfolio. He explained that Empower was not offering options and all of the funds were managed by ARMB, but Empower provided the services. The study by Callan showed that due to the lack of information provided to Empower, the management of the accounts was not as successful as it could have been. The division worked with the board on its decision to shut down fund management by Empower for new participants and ensure that it was common knowledge that the management accounts would be successful despite the fact that the fees were being paid. He argued that Empower did not have access to enough information to manage accounts successfully. There was revised software in process that would allow the account portfolio to be managed according to the expectations recommended by Callan.

Mr. Desai continued that the division was working with the existing populations to educate individuals on the situation. Participants were being told how successful the management of the account could be if the participants provided more information to Empower. The division thought that if the behavior of the participants was corrected, the account management service could be offered in the future and would be much more accurate. If the management services were not offered, DB plan participants would need to manage their own retirement plans and retain a financial advisor. He thought that the cost of seeking independent management would be higher than the fees associated with Empower. The fees represented the average fees compared to other companies and vendors offering similar services. The division would continue to alter and manage the services that were offered and would also rebuild services and find new services. He emphasized that the management account was part of the services that were offered by Empower based on the request by the division.

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Representative Stapp commented that he often heard that teachers and state workers would not have access to social security. He asked what the process would be for a TRS participant in the state to obtain social security benefits.

Ms. Lea responded that the process would first need to be initiated by the employer. Once the request to participate

was made, there would then need to be a vote by the employees. There were two ways to conduct the vote: by majority vote or by a divided vote. If there was a majority vote and social security passed, all of the employees would participate in social security. If it was a divided vote, those who wanted to join social security would begin participation but those who did not want to join would continue without social security coverage. Once an employee left the job, any replacement employee would be automatically enrolled into social security.

Representative Stapp asked for clarification that the school district would need to ask employees if the employees wanted to participate in social security benefits and request a vote. The employees could then determine individually if they would like to participate in social security.

Ms. Lea responded that if an employer decided to pursue social security, the state's social security administrator would discuss the particulars with the employer. One of the things that would need to be considered particularly for teachers would be the Windfall Elimination Provision, which would offset retirement benefits from social security by any other earned benefits with an entity that did not offer social security.

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Co-Chair Johnson reviewed the agenda for the following day's meeting.

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ADJOURNMENT

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The meeting was adjourned at 3:24 p.m.