

HOUSE FINANCE COMMITTEE
January 29, 2025
1:34 p.m.

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CALL TO ORDER

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

MEMBERS PRESENT

Representative Neal Foster, Co-Chair
Representative Andy Josephson, Co-Chair
Representative Calvin Schrage, Co-Chair
Representative Jamie Allard
Representative Jeremy Bynum
Representative Alyse Galvin
Representative Sara Hannan
Representative Nellie Unangiq Jimmie
Representative DeLena Johnson
Representative Will Stapp
Representative Frank Tomaszewski

MEMBERS ABSENT

None

ALSO PRESENT

Kathy Lea, Director, Division of Retirement and Benefits, Department of Administration; Christopher Novell, Chief Financial Officer, Division of Retirement and Benefits, Department of Administration.

PRESENT VIA TELECONFERENCE

David Kershner, Actuary, Arthur J. Gallagher and Company, South Carolina; Steve Ramos, Chief Health Administrator, Division of Retirement and Benefits, Department of Administration.

SUMMARY

OVERVIEW: FUNDING STATUS PERS AND TRS

Co-Chair Josephson reviewed the meeting agenda.

^OVERVIEW: FUNDING STATUS PERS AND TRS

Co-Chair Josephson reminded members that the committee had heard a previous presentation by the Alaska Gasline Development Corporation (AGDC) [on January 28, 2025, at 1:52 p.m.]. He noted that every year, there were statewide items that were not specifically agency-funded, and there were issues with past service costs, which related to Tier I through Tier III of the Public Employees' Retirement System (PERS) and the Teacher's Retirement System (TRS). He reminded the committee that there was a large appropriation around nine years ago when the state was in a better financial position.

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KATHY LEA, DIRECTOR, DIVISION OF RETIREMENT AND BENEFITS, DEPARTMENT OF ADMINISTRATION, introduced herself and explained that she had worked with the Division of Retirement and Benefits (DRB) for 33 years.

CHRISTOPHER NOVELL, CHIEF FINANCIAL OFFICER, DIVISION OF RETIREMENT AND BENEFITS, DEPARTMENT OF ADMINISTRATION, introduced himself. He had recently taken over as CFO of DRB and noted that other testifiers were available online for questions.

Mr. Novell introduced the PowerPoint presentation "State of Alaska Department of Administration; Division of Retirement and Benefits; Presentation to the House Finance Committee" dated January 29, 2025 (copy on file). He proceeded to slide 3 which displayed the membership count of PERS and TRS as of June 30, 2024. He provided a breakdown by tier and employment status and explained that 22 percent of PERS participants were enrolled in the defined benefit (DB) plans [Tiers I through III], while 78 percent were in the defined contribution (DC) plan (Tier IV). Similarly, TRS had a 77 percent to 23 percent split between the DB and DC plans. He noted that the DB tier had been closed in 2006 and it was expected that the membership split would continue to shift toward the DC plan over time.

Mr. Novell moved to slide 4 which illustrated the investment experience and the actuarial rates of return expected to be earned by the plans. He pointed out that the

2024 valuation was still in draft form and would be officially submitted to the Alaska Retirement Management Board (ARMB) on March 11, 2025. The assumed actuarial rate of return remained at 7.25 percent for both PERS and TRS for the third consecutive year. Based on the fair market value of assets, PERS and TRS had returns of 8.8 percent and 8.9 percent, respectively. The draft valuation of assets showed an 8 percent return for both systems, using a five-year smoothing method to mitigate volatility. The assumptions were reviewed every four years and were submitted to ARMB.

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Mr. Novell proceeded to slide 5 and the funded status of the pensions. He stated that the PERS pension liability for 2024 stood at \$17 billion in draft form and the actuarial valuation of assets was \$11.6 billion, resulting in an unfunded liability of \$5.5 billion, or 68 percent unfunded [this statement was later corrected]. He clarified that when using the fair market value of assets, the unfunded liability was similarly calculated at 67.7 percent. Notably, the unfunded liability ratio had remained consistent for the past three years for both PERS and TRS.

Representative Hannan noted that that the slide showed the funded ratio at 68 percent for PERS and questioned whether it was the unfunded ratio that Mr. Novell had referred to.

Mr. Novell replied that he misspoke, and the 68 percent was indeed the funded ratio, not the unfunded ratio, as reflected on the slide.

Mr. Novell continued to slide 6 which showed the funded status of health care. He explained that the health care system presented a different scenario, with positive figures in columns C and F indicating that the 2024 funding ratio was 143 percent for PERS and 150 percent for TRS. The slide showed that the health care system was overfunded.

Co-Chair Josephson asked about the health care funding, recalling that there had been significant concerns about health care funding when the DB program was closed in 2006. He noted that some reform proposals to bring back traditional pensions typically avoided adding significant health benefits due to concerns about over funding. He

asked how the health care portion had become overfunded despite the concerns.

Mr. Novell deferred the question.

Ms. Lea responded that the improvement in health care funding was primarily due to a federal program known as the Employee Group Waiver Program (EGWP). She noted that DRB had been a recipient of EGWP funds for several years, which provided considerable discounts. Although the division could not predict the exact amount of funds it would receive each year from the federal government, the influx of funds had contributed to the improvement in health care funding. Additionally, cost containment measures had further helped stabilize the funding.

Co-Chair Josephson asked whether reformers should consider EGWP when discussing health benefits for retirees.

Ms. Lea responded that the division did not take a position on whether EGWP should be included in proposals for adding significant health benefits for retirees. The legislature provided the plans and the division simply implemented the plans.

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Representative Stapp remarked that the unfunded liability on the pension side was significantly greater than the total amount on the health care side. He asked what percentage the fund would need to perform at in order to clear the liability, assuming no additional contributions were made. He estimated that the fund would need to perform at around 18 percent annually to clear the liability by 2040.

Mr. Novell responded that he would follow up with the information.

Co-Chair Josephson asked for clarification that Representative Stapp was asking if the liability would be cleared by 2040.

Representative Stapp explained that the fund was currently 68 percent funded and he was asking for a ballpark estimate of the required performance for the fund to clear the liability by 2040.

Mr. Novell replied that he would follow up with the information. He suggested that the actuary from Gallagher provide additional information.

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Representative Stapp posed his question to Mr. David Kershner. He asked what the annualized rate of return on the fund would need to be in order to clear the liability.

DAVID KERSHNER, ACTUARY, ARTHUR J. GALLAGHER AND COMPANY, SOUTH CAROLINA (via teleconference), responded by explaining that the question of how the fund would perform without additional state contributions had not been considered before, and no relevant analysis had been conducted. He stated that for a pension plan to be sustainably funded, the money coming in from both contributions and investment income must equal the amount going out in benefits and expenses. He noted that if the assets performed better than expected, the required contributions would decrease, and if the assets underperformed, the required contributions would increase. He clarified that if the state were to stop making additional contributions and only rely on the contributions from employers, which would be 22 percent for PERS and 12.56 percent for TRS, the fund would need to generate excess investment earnings to make up for the shortfall. While Gallagher had not done projections on the scenario, he assured the committee that the actuaries could perform the analysis and follow up.

Co-Chair Josephson asked if someone could explain the meaning of the 22 percent for PERS and 12.56 percent for TRS contributions.

Ms. Lea responded that the 22 percent contribution for PERS was set in statute. Employers were required to pay 22 percent of total salaries for their employees towards the unfunded liability and funding the benefits. She explained that the TRS contribution rate was 12 percent, which was also set in statute. She noted that in the past, each employer was responsible for funding benefits for their own group of employees, but the process had since changed. The state now provided what was known as an "on-behalf" contribution.

Representative Hannan asked for clarification regarding industry standards for acceptable levels of pension funding. She recognized that achieving 100 percent funding was a common goal, but many pension funds were not fully funded and still remained solvent. She asked for the typical pension ratios that were required to maintain a smooth path forward. She asked what the industry norms were.

Mr. Novell responded that a 90 percent funded ratio was generally considered a comfortable industry standard for pensions.

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Co-Chair Josephson asked how many states achieved the 90 percent goal for pension plans.

Mr. Novell responded that he would follow up with the information. He continued to slide 7, which included a graph that depicted the funding status for PERS and health care side by side, with the caveat that the pension and health care funds were completely separate and should not be viewed as affecting each other. The chart showed the PERS pension in blue and health care in orange. He highlighted that the PERS pension was below the 100 percent mark, while the health care funding exceeded 140 percent.

Representative Galvin asked whether there were any consequences for having an overfunded health care fund. She wondered what was typically done in other states in such situations. She asked what the gold standard for funding levels was and what the division's desired level was.

Mr. Novell deferred the question to Mr. Kershner.

Mr. Kershner responded that the question of what could be done with overfunded health care liabilities had been raised by ARMB trustees over the years. He explained that according to legal advice, the excess health care funds could not be used to cover the pension fund shortfall. The health care funds were legally segregated in a trust and could only be used for the benefit of the participants and their beneficiaries. The health care fund could not be accessed to address the pension fund's shortfall even though it was overfunded.

Mr. Kershner stated that the division was working towards reaching 100 percent funding for the pension trust. If the funding trend continued as projected, the pension trust was expected to reach 100 percent funding by FY 48. He emphasized that from an actuarial perspective, the key concern was not the funded status or funded ratio at any specific point in time, but the trend in the funded ratios. The goal was to prevent the ratios from declining as time progressed, and instead to see the ratios steadily rise.

Mr. Kershner continued that one of the important factors to consider when reviewing the funding status chart was the change in the assumptions used to discount future benefits, which affected the size of the liabilities. He relayed that in 2006, the blue bar indicating the funded status of the pension plan was around 80 percent, but the funded ratio was currently just below 70 percent. The assumptions on the interest rate had changed over time, such as the expected return on assets. In 2006, the assumed interest rate was around 8.5 percent, but it had gradually declined due to adjustments in future expectations for equity returns, bond yields, and other factors impacting the investments of the trust assets. The current interest rate assumption was 7.25 percent.

Mr. Kershner noted that the liabilities were highly sensitive to any changes. For example, for every 100 basis point change, the liabilities would change by approximately 11 percent to 12 percent. As the interest rate assumption decreased, the liabilities increased, and conversely, the liabilities would decrease if the interest rate increased. He emphasized that funding was a "moving target" because the assumptions were always being adjusted. The statutes required the assumptions to be evaluated at least once every four years and the interest rate was the primary driver, although many other assumptions also played a role.

Mr. Kershner stated that the goal was to improve the funded status over time. He acknowledged that there would be fluctuations due to market returns and changes in assumptions. The long-term aim was to reach a 100 percent funding status, which was what the funding policy adopted by ARMB was designed to achieve. The health care liabilities had increased significantly due to the adoption of EGWP, but favorable cost containment measures implemented by the DRB had helped stabilize the health care costs, which led to more a favorable valuation of health

care liabilities. He emphasized that the increases in health care costs were not as significant as the costs had been in prior years.

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Representative Galvin understood that the pension trust was projected to reach 100 percent funding by 2048, based on the current trend. The current projection was at 7.25 percent, but it had increased since the projection was made. She understood that the gold standard was around 95 percent funded. She recalled in some prior hearings that 90 percent had been expressed as a goal. She was grateful that Mr. Kershner was hoping to reach 100 percent.

Co-Chair Josephson asked how many states had DB plans.

Mr. Kershner replied that every state had DB plans, but Alaska was unique in that it had closed its DB plans to new hires in 2006. He noted that Alaska was also one of the few states that funded both medical and health care liabilities for its employees, a practice not commonly seen across other states. The differences made it difficult to compare Alaska's pension system directly with others.

Co-Chair Josephson asked how many states had DB plans for people who were "hired yesterday" in the state.

Mr. Kershner responded that approximately 47 other states still maintained active DB plans for their employees.

Co-Chair Josephson asked what the typical funded ratio was in the 47 states.

Mr. Kershner responded that funded ratios varied significantly from state to state. Some states, like South Dakota, had their pension funds fully funded or even over 100 percent funded, while other states, such as Illinois, had a much lower funded ratio at around 40 percent. He stressed that while the funded ratio varied by state, it was more important to focus on the long-term trend of the funding ratio rather than a specific point in time. During FY 21 and FY 22, the market experienced significant declines that led to negative returns and lower funding ratios; however, the funding ratios had since rebounded, underscoring the importance of looking at trends rather than short-term fluctuations.

Co-Chair Josephson agreed that the trend line was crucial.

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Representative Allard asked how many states did not have a sales tax or income tax.

Mr. Novell asked to defer the question to Mr. Kershner.

Representative Allard rephrased her question. She asked if the absence of sales tax or income tax in certain states impacted the ability to afford a DB plan.

Mr. Kershner replied that there were many factors to consider when deciding whether to maintain a DB plan for new hires, and the lack of sales or income tax was not within his area of expertise. He added that offering DB plans could make it more difficult to attract and retain employees, particularly in sectors like police and fire services, which typically offered generous pension plans.

Representative Allard clarified that her question was specifically about whether the absence of the taxes impacted the financial feasibility of maintaining DB plan.

Co-Chair Josephson explained that Mr. Kershner had answered that it was beyond his area of expertise.

Representative Johnson thought that hybrid systems that combined DB plans and other forms of pensions could be more similar to Alaska's pension system, as opposed to traditional DB systems. She suggested that the question of how many states had DB plans was difficult because the answer was not as clear-cut, since pension plans were structured in many different ways.

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Ms. Lea relayed that she would follow up on the questions relating to DB plans in other states.

Mr. Novell continued on slide 8 which showed the funded ratio for the TRS pension and health care plans. The chart showed that there was an overfunded health care fund and an underfunded pension fund.

Mr. Novell moved to slide 9, which illustrated the correlation between the actual rate of return and the actuarial funded ratio. Factors such as members leaving or joining the retirement system impacted the funded status. He emphasized that the metrics presented focused purely on the effect of the rate of return on the fund. The percentages in bold under the actuarial funded ratio indicated an increase in the funded ratio in the last year, which could be compared to the actual rate of return on the left side of the slide. Since 2000, the assumed actual earnings rate had been changed three times, most recently in 2022 to 7.25 percent. He noted that it was important to consider the impact of the \$3 billion infusion that occurred in 2015 when analyzing the data.

Representative Stapp asked why the assumptions for the rate of return always seemed to be wrong in one direction. He observed that since 2004, the actual returns had been approximately 100 basis points lower than projected. He asked what it would look like if the returns were 100 basis points off in 2048, assuming the current rate of returns.

Mr. Novell deferred the question to Mr. Kershner.

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Mr. Kershner replied that the assumptions used for determining funding contributions and liabilities were long-term expected assumptions, which were considered best estimates. He clarified that actual returns were rarely exactly the same as assumed returns. Typically, actual returns would either be higher or lower than what was assumed, but the important takeaway was the long-term trend. He highlighted that the 30-year average return for both PERS and TRS was about 7.8 percent, which was close to the long-term assumption. He acknowledged that the outlook today was different from 20 years ago when the assumption was 8.25 percent because long-term expectations for equities and bond yields were lower now than they were two decades ago, which was why the assumption had been adjusted downward. He noted that the trend was consistent with every other state pension plan in the country. He emphasized that the actuaries did not focus on one-year or two-year periods but always looked at the long-term outlook because pension benefits were expected to be paid out for the next 20 to 40 years.

Representative Stapp clarified that he agreed with Mr. Kershner that it would have been strange if the actual rate of return had exactly matched the assumed rate of return. However, the assumption had always been revised in the same direction: downwards. He asked why the projected rate of return could not have been revised upwards to help the state pay off the liability. He noted that the last 10 years of the fund's performance had shown an average return of about 7.3 percent for both funds. He asked how long-term liability would be impacted if the average rate of return in the next decade was 6.5 percent.

Mr. Kershner asked for clarification that Representative Stapp was asking what the long term liability would be if 6.25 percent was assumed rather than 7.25 percent.

Representative Stapp responded, "Sure."

Mr. Kershner responded that for every 100 basis point decline in the investment assumption, liabilities would increase by about 10 percent or 11 percent. If the assumption had been lowered by just 50 basis points to 6.75 percent, the liabilities would have increased by about 5 percent to 6 percent.

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Representative Bynum remarked that there was a significant change in the funded ratio between 2001 and 2002. He asked what events had occurred during that period that led to that change.

Co-Chair Josephson assumed that the reason was the dot-com recession.

Mr. Kershner replied that in 2001 and 2002, there had been two consecutive years of negative returns exceeding 5 percent, which had caused significant accumulated losses. The declining returns had been a key driver in the funded ratio dropping from 100 percent to 75 percent. There could have been other factors at play, such as changes in demographics or large salary increases in 2002, which would have also driven up the liabilities. He clarified that the slide only reflected asset returns, but changes in demographics and salary expectations also could have contributed to the shift in the funded ratio. While many

factors had influenced the funded ratio, the negative returns in those two years had played a large role.

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Mr. Novell continued on slide 10, which was related to slide 7. The slide displayed the unfunded actuarial liability in dollar amounts rather than as a percentage of the total liability. Since 2006, the pension fund, represented in blue, and the health care fund, represented in orange, had both fluctuated. From 2018 onwards, the health care fund had moved from being underfunded to overfunded.

Mr. Novell continued to slide 11 and explained that the slide told a similar story for TRS, with the exception that the health care fund had been overfunded since 2017. He continued to slide 12 which displayed the history of legislation relating to additional state contributions, including the \$3 billion infusion into the plans in 2015 under HB 119. He mentioned that the board-adopted rate for 2026 would be \$79,807,000 for PERS and \$138,980,000 for TRS.

Co-Chair Josephson asked if the legislature could decide not to provide the contributions requested by ARMB. He wondered if the legislature could simply choose not to allocate the \$79 million for PERS, for example.

Mr. Novell responded that Alaska statutes governing PERS and TRS required an on-behalf contribution by the state.

Representative Stapp asked how many states looked to the federal government for a "bailout" when the pension plans became underfunded. He asked if Alaska would also be able to receive funds or would it be required to pay from the Permanent Fund.

Mr. Novell deferred the question to Mr. Kershner.

Mr. Kershner responded that he was not sure about what other states had received from the federal government beyond the EGWP subsidies but noted that he could look into it.

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Mr. Novell continued to slide 13 which showed the additional state contributions each year from FY 26 to FY 39, with the top entry reflecting the adopted rate for 2026. He indicated that he would explain more about additional state contributions in the following slides.

Co-Chair Josephson commented that he was pleased to see some consistency and predictability. He asked if the division or the board was confident that the statewide contribution in 2033 would be \$273 million and not significantly more or less.

Mr. Novell deferred the question to Mr. Kershner.

Mr. Kershner responded that the projected figures assumed future experiences would follow the established assumptions, including the 7.25 percent return on assets. He added that while he could not guarantee that the 2033 contribution would be exactly \$273.5 million, he had provided the board with alternative projections based on varying assumptions. In the upcoming March meeting, ARMB would be discussing future projections and what could happen if there were adverse experiences, such as higher-than-expected inflation or bad asset returns over a few years. He emphasized that the board would show some sensitivity to the variables, but noted that the projections would evolve over time as new data became available. He explained that the numbers in the projections were not static, and that the projections in the prior year were different due to having one more year of experience. He added that while they could not guarantee that the 2033 contribution would remain at \$273 million, the assumptions made could lead to coincidental accuracy if the future experience unfolded exactly as projected. He stressed the dependency of the numbers on evolving experience compared to the underlying assumptions.

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Mr. Novell moved to slide 14 and detailed the table showing preliminary rates for contributions to PERS and TRS alongside the rates adopted by the board. He pointed out that the preliminary reports indicated a health plan normal cost rate of 1.97 percent for PERS and 2.15 percent for TRS, which was influenced by the health plan's overfunded status. The overfunding led the board to adopt a zero rate for the health plan. He explained the savings at the bottom

of the table, which were calculated as the difference between the preliminary and adopted contribution rates.

Mr. Novell continued on slide 15 which showed actuarial projections of the funded level of the health care trust over the next 15 years, both with and without normal cost contributions. Normal costs referred to the annual costs of future benefit payments and administrative expenses under the actuarial cost method.

Co-Chair Josephson understood that funds could not be transferred between the trust's "buckets." He asked if the board could suspend payments to the health care trust.

Mr. Novell deferred the question to Ms. Lea.

Ms. Lea confirmed that the board could set the rates for the health care portion of the trust, and due to the overfunded status of the health care plan, the contribution rate for health care was set at 0 percent. She clarified that ARMB revisited the issue each year, which involved evaluations by the actuary to assess trends and determine when additional contributions might be needed.

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Representative Galvin understood that the funding level was expected to exceed 200 percent in the future and was already projected to exceed 150 percent by 2035. She raised a concern about what actions might be taken when the fund reached such a high level of funding. She asked if the board could take any actions to provide some of the surplus funds back to the recipients, questioning whether the fund was being "hoarded." She wondered what legal options existed and whether the legislature needed to act to allow for such a payout, or if the situation required other types of actions.

Ms. Lea responded that the increased funding level helped avoid raising costs for employees, allowed for expanded benefits like travel benefits, and supported program enhancements. She emphasized that the goal of maintaining a high level of funding was to support these benefits and that high funding levels helped sustain the program over time.

Representative Galvin asked why the fund was growing at such a rapid rate. She reiterated her concern about the fund reaching 150 percent, especially since it seemed that a 100 percent funding level was adequate. She asked whether the board had considered a payout to the beneficiaries or other measures to address the surplus funds. She asked if it was normal to allow the fund to continue growing at this rate.

Ms. Lea replied that the funds were governed by trust fund regulations, which had strict rules about how the funds could be used. She explained that the fund could not be used to make payouts to participants directly. The available levers were limited to keeping co-pays and premiums down or adding benefits.

Representative Galvin asked if the restriction on payouts was due to statutory requirements or if it was the nature of the board's rules. She asked whether legislators had any options to address the surplus funds or if the current approach was the best one. She wondered if any other states in similar situations had taken different actions.

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Ms. Lea clarified that the restrictions were due to federal rules that governed the trust funds. The board had to comply with the rules and there were no permissible options for making payouts to beneficiaries.

Representative Hannan asked how long the federal government would continue to provide funds for the program when there was no clear evidence of need. She asked whether the federal government's contributions were guaranteed as long as EGWP was in place or if the funding could be discontinued.

Ms. Lea responded that the continuation of EGWP payments was not guaranteed and the payments were dependent on the federal government's decisions from year to year. She explained that the federal government could stop the payments at any time, and the amount received could also vary.

Representative Hannan asked whether the chart on slide 15 assumed that EGWP would continue to be contributed at its

current rate of return, especially considering that the projections show that by 2039, TRS could be at 245 percent.

Ms. Lea confirmed that the projections assumed an average level of EGWP reimbursement.

Representative Hannah shared a personal anecdote about her husband needing surgery. She explained that while they could travel and get the surgery covered by insurance, her husband was insisting on having the procedure locally. She acknowledged that while she appreciated the expanded benefits, she felt some members were surprised by the idea of such additions.

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Representative Tomaszewski expressed surprise at how benefits could be arbitrarily added to the health care program. He asked for clarification on the regulations and rules that allowed the board to make such decisions and requested a list of what had been added to the benefits over time.

Ms. Lea responded that the board did not make decisions on benefits "willy-nilly" and that any changes were based on careful consideration of funding availability. She explained that decisions also took into account the potential impact if the EGWP funding was no longer available. The expansion process was thoroughly considered, and no coverage was added without the approval of the actuary and the board. She clarified that the state could afford the current plan.

Representative Stapp asked how much of the \$8.5 billion in additional contributions to the retirement system were allocated to the health care section.

Ms. Lee explained that most of the contributions were allocated to PERS and TRS. She offered to follow up with detailed information.

Representative Stapp thought that the state had made additional payments to the health care portion, at least initially. He asked if his understanding was correct.

Ms. Lea responded in the affirmative. The health plans were unfunded at one point in the past and some of the on-behalf payments went to the health plans.

Representative Stapp asked if it was possible to pay back some of the extra money contributed by beneficiaries instead of continuously expanding benefits. He suggested that it would be a favorable situation for DRB.

Ms. Lea responded that since the funds were placed in a trust for health care purposes, the funds could only be used for health-related expenses. Once the money was in the health care trust, it could not be used for anything else.

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Co-Chair Schrage asked if DRB had the authority to manage the plans and expand or reduce benefits based on the financial status of the fund.

Ms. Lea replied in the affirmative. The division had the authority to administer the plan as long as it was meeting industry standards and adhering to federal regulations governing health plans. The statutes governing the health plan also outlined that a health plan would be maintained, which provided the legal framework for the division's actions.

Co-Chair Schrage asked why 90 percent was considered a healthy target for the health care portion instead of aiming for 100 percent or more. He wondered what the potential downsides were of being overfunded and whether there were any issues with reaching a funding level of 100 percent or higher.

Ms. Lea responded that being well-funded was not inherently bad. The funding ratios were assessed based on the ability to pay full benefits if everyone who was not already retired suddenly became eligible for retirement. For example, with a 67 percent funding ratio, the plan would be able to pay 67 percent of full benefits if everyone retired immediately. However, it was highly unlikely that all non-retired members would retire all at once and the funding ratio needed to account for both the benefits being paid to current retirees and those expected to retire in the future. She clarified that being overfunded would mean there would be fewer contributions required from the state

in the future, and the system would still have enough funds to pay out benefits to retirees, even if all members were eligible to retire at once.

Co-Chair Schrage understood that the downside of being overfunded was essentially the sacrifice of too much state money for benefits that would not be needed immediately.

Ms. Lea replied that if every member was to become eligible to retire at once, it would mean that less money would need to be allocated for remainder of the life of the plan. She noted that longevity was a challenge. Even if the fund was overfunded today, there was no certainty that it would remain overfunded in the long run. The benefits were paid out for members who had contributed for a relatively short time but were receiving benefits for many more years, sometimes 40 years or more.

Co-Chair Schrage asked what the goal was for the funding level. He asked if it was 100 percent.

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Ms. Lea confirmed that the goal was to be 100 percent funded. She stressed that a 100 percent funding ratio would ensure that the obligations could be met without sacrificing significant state funding.

Mr. Novell moved to slide 16, which outlined the FY 26 contribution rates for the DB plans and the rate calculation methods. The slide detailed the contributions from both employees and employers. The employee rates were shown in the first row, followed by the employer rates, which were capped by statute at 22 percent for PERS and 12.56 percent for TRS. The slide showed the additional state contributions, including the DC rate, which was 6.33 percent for PERS and 8.77 percent for TRS. As a result, the total employer required contribution per employee for FY 26 would be 28.33 percent for PERS and 31.33 percent for TRS.

Mr. Novell moved to slide 17, which showed the FY 26 DC rates for Tier IV employees. He explained that 8 percent of the gross income would be paid by the employee, with an employer match of 5 percent for PERS and 7 percent for TRS. The employer rates were added together, and the difference between these amounts and the 22 percent for PERS or 12.56

percent for TRS would go towards funding the DB plans and liabilities.

Co-Chair Josephson asked how teachers ended up without Alaska Supplemental Annuity Plan (SBS) dollars and Social Security coverage.

Ms. Lea responded that the situation began in the 1940s when the teachers had their own state retirement system. In 1955, schools and political subdivisions were allowed to enroll in Social Security, either in addition to their state retirement plan or instead of it. A referendum was held among Alaska teachers, and they voted not to join Social Security. As a result, teachers were excluded from the Social Security system and SBS was designed as a replacement for Social Security. However, the SBS program was available to those eligible for Social Security, which was why it did not apply to teachers.

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Representative Tomaszewski noted that there was a bill currently in circulation that would allow teachers to join SBS if it were to pass. He asked whether Ms. Lea thought it was a good idea.

Ms. Lea responded that it depended on individual circumstances. If teachers joined the SBS system, they would gain an additional supplemental account to draw on, which they currently did not have. However, teachers would be required to contribute 6.13 percent from their paychecks. She reiterated that teachers would likely have varying opinions on the idea. Some might view it as a positive change, while others might not. The proposal would provide an additional source of funds that individuals could use to accrue retirement savings.

Representative Bynum stated that it was clear to him that the values presented and the various retirement plans were not all equal. The costs associated with each plan were significantly different and the actual dollar value for DB plans compared to DC plans was not easily discernible based on the provided information. He thought it would be helpful to understand who was actually being covered by these plans. He referenced slide 14, where the state liabilities and non-state employee liabilities for the defined contribution plan were outlined. He did not think there was

a clear connection between those liabilities and the parties responsible for paying the liabilities. He did not think the clients of the plans, such as the subdivisions, the state, and the municipalities, were clearly identified. He emphasized that it was important to clarify who would be impacted by the various plans and the costs associated with the plans.

Ms. Lea responded that she could provide the committee with a list of the participating employers within PERS and TRS. The employer rate was currently set by statute as a flat rate due to the volatility experienced by employers when each entity was responsible for its own rate. The fluctuation had made budgeting difficult for employers. She explained that during periods of low or negative returns on investments, employers faced rate increases that some could not afford. She relayed that it was essential to consider the impact on employers when developing any retirement plan, particularly regarding the costs that would be incurred.

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Representative Bynum directed attention to slide 17, where the DC plan was discussed. He noted that the calculations for the amounts paid into the plan were shown, with the difference of 22 percent being allocated to DB. He inquired if there was any indication of how many employees were still required to contribute to the past liability.

Ms. Lea replied that employees were not responsible for paying the past liability. Employee contributions went directly into individual investment accounts and the additional amount was paid by the employers. She explained that the figures detailing how much was collected annually were not prepared at the time but she could follow up.

Representative Bynum understood that the 22 percent figure referred to the employer's contribution, but the employer was also responsible for paying the past liability for previous employees. The contribution benefited past employees rather than the current workforce. He thought that current employees were receiving their 5 percent contribution, along with other percentages that went into health care and disability funds. However, it was the municipality, city, or borough that was responsible for the past liability, which did not directly benefit the current

employees. He thought the situation had an impact on the ability of employers to pay their current employees. He was interested in learning what percentage of remaining liability was present for the positions that were currently being filled.

Mr. Novell continued, noting that slide 18 displayed the variation of the actuarial rate from 2008 to 2026 and the ARMB adopted rate for both retirement systems.

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Mr. Novell proceeded to slide 19, which showed the projected benefit recipients up until 2053. As more individuals retired, the number of pension recipients was expected to rise, peaking for PERS in 2030 and for TRS in 2031. During the indicated time frame, all employees were enrolled in the DC system and not DB, which meant that the number of DB recipients would naturally decrease.

Mr. Novell moved to slide 20, which depicted a similar trend to the previous slide, but in monetary terms. He explained that TRS was expected to peak with \$687 million in benefit payments in 2033, while PERS was projected to peak with \$1.5 billion in 2038. Over time, the recipient dollars were forecasted to gradually decrease, nearing zero by the end of the century.

Co-Chair Josephson asked if anything could be concluded from slides 19 and 20 regarding the difference in assumed turnover between a DB and a DC plan.

Mr. Novell responded that turnover, along with other demographic factors, was taken into account in the assumptions made going forward.

Co-Chair Josephson asked if any analysis had been done regarding when the cash-outs for Tier IV for PERS and Tier III for TRS might occur and whether any pressure on the accounts had been anticipated due to the cash-outs.

Mr. Novell deferred the question to Mr. Kershner.

Mr. Kershner responded that slide 20 only represented the DB plan pension benefits. He noted that projections for the DC plans, Tier IV for PERS and Tier III for TRS, were not included. Both of the plans were overfunded and no strain

on the funds was expected as the DB participants approached their retirement years.

Mr. Kershner added that although the DC plan had only recently begun to see a handful of participants receiving benefits since the plan's inception in 2006, the trust funds were still in a strong position. He attributed this stability in part to the EGWP subsidies coming from the federal government. He emphasized that the trusts were not projected to face any liquidity issues.

Mr. Kershner clarified that of the \$3 billion contribution made by the state in 2015, \$1 billion had been contributed to PERS, and \$2 billion had been contributed to TRS. He explained that 100 percent of the \$1 billion contribution for PERS went into the PERS pension trust, with none allocated to the PERS health care trust. Approximately \$1.7 billion of the TRS contribution went into the TRS pension trust, while about \$300 million went to the TRS health care trust.

Mr. Novell turned the presentation over to Mr. Steve Ramos.

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STEVE RAMOS, CHIEF HEALTH ADMINISTRATOR, DIVISION OF RETIREMENT AND BENEFITS, DEPARTMENT OF ADMINISTRATION (via teleconference), continued on slide 21 detailing EGWP, which was a Medicare Part D prescription drug plan. He clarified that the subsidies from Medicare were part of the plan. The total amount of subsidies for the current year was expected to approach \$100 million.

Mr. Ramos continued to slide 22, which showed a breakdown of the different segments of the subsidy provided by Medicare. He explained that each line represented a different piece of the subsidy. He noted that the expected total subsidy for 2024 was \$102 million, as shown on the right column of the slide.

Representative Galvin asked for more information about the unpredictability of EGWP. She noted that in 2021, 2022, and 2023, the direct subsidy amounts were significantly lower, even showing negative amounts, and that in FY 24, there was an expected large positive amount. She asked why the subsidy amounts were negative during those years.

Mr. Ramos responded that he did not have the answer but suggested that Mr. Kerschner might be able to provide more insight.

Mr. Kerschner explained that he was unable to provide a direct answer, as the estimates for the EGWP were not developed by Gallagher. He understood that the state worked with Segal Consulting to generate the estimates for the EGWP subsidies. He noted that Gallagher used the estimates provided by Segal for its projections and the valuation of future benefits. He added that the EGWP subsidies had almost doubled since 2020. As the subsidies had increased, the future expectations for the EGWP subsidies had also risen, which contributed to a reduction in health care liabilities. He explained that these subsidies acted as "negative benefits" helping to offset the liabilities. Consequently, the increase in EGWP subsidies had a notable impact on the state's health care liabilities by reflecting the higher subsidies in the calculations.

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Representative Hannan directed attention to the terms "low-income premiums" and "low-income cost sharing" used on slide 23 in relation to EGWP. She asked to be provided with the definition of "low income" used in this context, questioning whether it was based on the beneficiaries of the pension program and if it applied to those who were qualified or deemed low income. She asked if the definition was tied to a poverty-level percentage or if it related to a state-defined ratio of low income, rather than being tied specifically to pension beneficiaries.

Mr. Kerschner responded that he was not sufficiently familiar with the details to answer the question.

Mr. Ramos explained that the low-income premiums and low-income cost sharing were specific to individual members. Each member with a Medicare prescription drug plan was identified individually and each plan represented an individual person, which differed from most other insurance accounts where the subscriber and family members were included under a single account. He clarified that the low-income premium subsidy was designed for individuals who might be unable to cover their own premiums, while the low-income cost-share subsidy was provided when a drug's cost exceeded what the individual could afford. He noted that

DRB did not receive individual-level reporting but received aggregate numbers. He assured Representative Hannan that the subsidies were specific to the individual members.

Representative Hannan asked how many pension beneficiaries were deemed low income by the federal government under EGWP and whether the data presented on the slide could provide any insight. She asked whether the ratio in the calculations was relevant to the determination.

Mr. Ramos responded that while the information was not irrelevant, there were quite a few unknowns. He explained that a retiree who had worked for five years in a low-wage position might be considered low income upon retirement, while someone who had served for 30 years with a higher salary would likely not fall into that category. He indicated that it was possible to pull some numbers and offered to follow up if Representative Hannan desired.

Representative Hannan suggested that the issue should not be explored in too much detail because she thought that DRB had more pressing questions to address.

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Co-Chair Josephson asked if an individual who had five years of service and earned a relatively low salary but also had significant other income would be eligible for the subsidy. He wondered if the evaluation of eligibility for the subsidy was based solely on the person's income from their five years of service with the state.

Mr. Ramos responded that the evaluation would not be based solely on the person's income from the five years of service. He explained that the determination was made based on the individual's income, specifically the adjusted gross income from two years prior. He clarified that an individual with significant income from another source would not likely qualify for the subsidy.

Mr. Ramos continued to slide 23 which showed the cost trend rates. He noted that the projections presented in the slide were based on trends identified by DRB, with an approximate 6 percent trend in the cost of obtaining health care.

Mr. Novell proceeded to slide 24 which displayed the process timeline. The slide outlined the steps from

valuation to ARMB adopting the additional state contributions, with the objective of addressing the unfunded liability for PERS.

Representative Stapp asked for more information about the 22 percent additional municipal contribution and inquired where municipalities obtained the funds to make the contribution. He wondered if the money came from property taxpayers in most cases.

Ms. Lea responded that municipalities typically budgeted for the additional contribution each year. She clarified that the source of the funds could vary depending on the municipality, as different municipalities might draw from different pools of money to cover the contribution.

Representative Stapp noted that there was no sales tax in Fairbanks, and only property taxes were collected. He asked if, as a homeowner in Fairbanks, he would effectively be contributing to someone's pension retirement system via property taxes, even if that person had been born after the pension plan ended in 2006.

Ms. Lea responded that she did not have knowledge of how municipal budgets were funded. She clarified that DRB did not deal with the specifics of municipal funding and could not speak to whether purchasing a house and paying property taxes contributed to the 22 percent employer contribution.

Representative Stapp emphasized that property taxes were the only form of taxation in Anchorage and Fairbanks. He asked again if that meant he was indirectly paying into someone's pension system through his property taxes.

Ms. Lea reiterated that while she was aware that municipalities received various grants and had other sources of income, DRB was not an expert in municipal funding. She explained that any answer she provided could be inaccurate.

Representative Stapp suggested that the issue would likely arise again. He relayed that it was important to lay the groundwork for future discussions regarding the state's financial issues.

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

#

ADJOURNMENT

3:11:44 PM

The meeting was adjourned at 3:11 p.m.