

SCOMM

142:13

Alaska Retirement Management Board

Report to the Legislature

April 18, 2006

Gail Schubert, Chair

Larry Semmens, Chair Report Committee

Gary Bader, Chief Investment Officer

Strategies Considered

- Large Dollar Strategies
- Incremental Strategies
- Investment Returns
- Extend Amortization Period

Eliminating Retirement Systems' Unfunded Liabilities

- Large Dollar Strategies

- Pension Obligation Bonds
- Natural Resource Assets

- Incremental Strategies

- Past Service Cost Offset Accounts (PERS only)
- Retirement Benefit Liability Account
- Under Funded Liability Relief Account

Large Dollar Strategies

- Pension Obligation Bonds (HB 278)
 - Authorizing the Alaska Municipal Bond Authority to consider issuing pension obligation bonds (POBs) at the request of the state or a municipal government employer. HB 278 does not authorize any debt instruments to be issued. The state or a municipality would need to take a separate action to utilize this new ability of the Municipal Bond Bank Authority.
- Natural Resource Assets (HB 492)
 - A proposal to transfer a high value natural gas asset (specifics not yet available) to the retirement systems. If issues related to valuation could be reasonably addressed, the systems could possibly be fully funded thereby obviating the need for paying down the past service liability.

Incremental Strategies

- Past Service Cost Offset Account (PSCOA) (HB238)
 - a long-term solution to assist communities with growing unfunded liability payments.
 - a mechanism that aids employers as new defined contribution hires enter the workforce.
 - a reduction in non-state and non-school district employer past service cost contributions by approximately 56% over the course of a 25-year amortization period

Incremental Strategies

- Retirement Benefit Liability Account (HB375)
 - Money would be used for payment of the employer contributions to past service liabilities of the public employees' retirement system and teachers' retirement system for employers. Any income earned on the money would be appropriated back into the account.
 - Appropriations to the account would be \$400,000,000 for TRS and \$38,000,000 for PERS (HB376).

Incremental Strategies

- Underfunded Liability Relief Account (SB247-CRA)
 - Provides funds for municipal PERS employers to bridge the gap between the employer contribution rate set by ARMB, and the actuarial rate calculated by the state actuary

Investment Performance

Fiscal Year	2002	2003	2004	2005	2006 ⁽¹⁾
PERS	-5.48%	3.67%	15.08%	8.95%	14.44%

Source: Based on quarterly performance results as calculated by Callan Associates through December 31, 2005.

(1) Estimated Return based on annualizing actual results from July 1, 2005 through December 31, 2005.

Extend Amortization Period

Public Employees' Retirement System
Employer Supplemental Contributions, as of June 30, 2005
(\$ in thousands)

Amortization Period (years)	Employer Contribution Rate	Normal Cost Rate	Average Member Contribution Rate	Past Service Rate	Supplemental Contribution Rate	Supplemental Contributions
25	16%	21.32%	6.84%	17.95%	16.43%	\$260,726
30	16%	21.32%	6.84%	15.98%	14.46%	\$229,464
35	16%	21.32%	6.84%	14.66%	13.14%	\$208,517
40	16%	21.32%	6.84%	13.73%	12.21%	\$193,759
25	21%	21.32%	6.84%	17.95%	11.43%	\$181,382
30	21%	21.32%	6.84%	15.98%	9.46%	\$150,120
35	21%	21.32%	6.84%	14.66%	8.14%	\$129,173
40	21%	21.32%	6.84%	13.73%	7.21%	\$114,415
25	26%	21.32%	6.84%	17.95%	6.43%	\$102,037
30	26%	21.32%	6.84%	15.98%	4.46%	\$70,775
35	26%	21.32%	6.84%	14.66%	3.14%	\$49,828
40	26%	21.32%	6.84%	13.73%	2.21%	\$35,070

Total Salaries: \$1,586,891

Source: Buck Consultants

Extend Amortization Period

Teachers' Retirement System

Employer Supplemental Contributions, as of June 30, 2005

(\$ in thousands)

Amortization Period (years)	Employer Contribution Rate	Normal Cost Rate	Average Member Contribution Rate	Past Service Rate	Supplemental Contribution Rate	Supplemental Contributions
25	16%	21.25%	8.69%	29.58%	26.14%	\$146,655
30	16%	21.25%	8.69%	26.27%	22.83%	\$128,085
35	16%	21.25%	8.69%	24.06%	20.62%	\$115,686
40	16%	21.25%	8.69%	22.51%	19.07%	\$106,990
25	21%	21.25%	8.69%	29.58%	21.14%	\$118,603
30	21%	21.25%	8.69%	26.27%	17.83%	\$100,033
35	21%	21.25%	8.69%	24.06%	15.62%	\$87,634
40	21%	21.25%	8.69%	22.51%	14.07%	\$78,938
25	26%	21.25%	8.69%	29.58%	16.14%	\$90,552
30	26%	21.25%	8.69%	26.27%	12.83%	\$71,981
35	26%	21.25%	8.69%	24.06%	10.62%	\$59,582
40	26%	21.25%	8.69%	22.51%	9.07%	\$50,886

Total Salaries: \$561,038

Source: Buck Consultants

Policies to Improve Financial Health of the Plan

- No Enhancements to PERS and TRS Benefits for at least Two Years
- Index Health Deductible in New Plan

Short-Term Recommendations

- New Retirement Health Plan for New Members
- Health Care Cost Containment Initiatives
 - Preferred Provider Programs
 - Negotiated Drug Prices
 - Eligibility Reviews

Solution Goals

- Full Funding within 30 years
- Not cause severe disruption in public service
- State should participate in solution
- Accelerated contributions from employers should be rewarded
- State support should be equitable
- Should minimize supplanting Federal and other non-general fund costs

ALASKA RETIREMENT MANAGEMENT BOARD

FINAL
REPORT TO LEGISLATURE

April 14, 2006

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I. Introduction

As required by Senate Bill 141, the Alaska Retirement Management Board submitted its Report to the Legislature on January 20, 2006. At that time, the board provided the legislature with preliminary assessments, but noted that without updated actuarial data, it did not have information on which to base long-term recommendations. The board received a draft valuation report from the state actuary at its March meeting, and now offers this report transmitting the board's updated assessments and short and long term recommendations.

Senate Bill 141 charged the board with responsibility to report its findings and recommendations on the following five items:

1. the board's preliminary assessment of the financial health of all public employees' retirement plans and all teachers' retirement plans;
2. an assessment of the actuarial services purchased by the board;
3. recommendations for additional legislative or administrative policy to improve the financial health of the retirement plans;
4. short-term and long-term recommendations for addressing the unfunded liability of the retirement plans; and
5. recommendations for legislative procedures regarding fiscal notes for new legislation affecting the retirement plans.

The board's goal is to identify cost saving and funding strategies to fully fund the retirement obligations to our public employees with a minimal impact on the services to the residents of Alaska. This report contains the assessments and recommendations to achieve that goal. Sections I, II, and III update the information and analysis provided on January 20th, and a new Section IV outlining the board's recommended legislative action completes this report.

II. Report

A. Senate Bill 141 Report Requirements

1. *Preliminary Assessment of the financial health of all public employees' retirement plans and all teachers' retirement plans*

The system's actuary (Buck Consultants) presented a report to the board at its March meeting that reviewed the previous actuary's 2004 actuarial valuation and provided the 2005 actuarial valuation results for the public employees' retirement system and the teachers' retirement system. The funding ratios and unfunded liabilities of each system are as follows:

(a) Public Employees Retirement System (PERS) as of June 30, 2005. The PERS defined benefit plan funding ratio (valuation assets to liabilities) declined to 65.7% from 70.2%, and the plan's unfunded liability increased from \$3.4 to \$4.4 billion.

The average actuarially determined contribution rate for the PERS defined benefit plan was 32.43%, up from 28.19%. Valuation data is used to set contribution rates in the future. Therefore, June 30, 2005 valuation data is used to set contribution rates for fiscal year 2008. The board will set the FY08 contribution rate at its September meeting. In October, the board set the fiscal year 2007 contribution rate at 21.77%, a 5 point increase in the rate for the prior fiscal year. This was communicated to employers prior to the formation of the board. The five point increase followed a previously adopted regulation to limit increases in the contribution rate from year to year to five percentage points.

(b) Teachers' Retirement System (TRS) as of June 30, 2005. The TRS defined benefit plan funding ratio declined to 60.9% from 62.8% and the plan's unfunded liability increased from \$2.3 billion to \$2.5 billion.

The actuarially determined contribution rate for the TRS defined benefit plan was 42.14%, up from 41.78%. Valuation data is used to set contribution rates in the future. Therefore, June 30, 2005 valuation data is used to set contribution rates for fiscal year 2008. The board will set the FY08 contribution rate at its September meeting. In October, the board set the fiscal year 2007 contribution rate at 26.00%, a 5 point increase in the rate for the prior fiscal year, as communicated to employers prior to the formation of the board.

(c) Judicial Retirement System (JRS) as of June 30, 2004. The JRS defined benefit plan funding ratio was 88.01% and the plan had an unfunded liability of \$9.6 million. This system was not updated in the 2005 Valuation Report from the actuary.

The actuarially determined contribution rate for the JRS defined benefit plan was 37.37%. Valuation data is used to set contribution rates in the future. Therefore, June 30, 2004 valuation data is used to set contribution rates for fiscal years 2007 and 2008

(valuations are done every other year for this plan). The Commissioner of Administration set the fiscal years 2007 and 2008 contribution rates at 37.37%.

(d) National Guard and Naval Militia System (NGNMRS) as of June 30, 2004. The NGNMRS defined benefit plan funding ratio was 67.8% and the plan had an unfunded liability of \$6.4 million. This system was not updated in the 2005 Valuation Report from the actuary.

The actuarially determined contribution amount for the NGNMRS defined benefit plan was \$1,737,406. Valuation data is used to set contribution amounts for future years. Therefore, June 30, 2004 valuation data is used to set contribution amounts for fiscal years 2007 and 2008 (valuations are done every other year for this plan). The board set the fiscal years 2007 and 2008 contribution amount at \$1,737,406 for each year.

2. Assessment of the actuarial services purchased by the board

In November 2005 the division, on behalf of the board, procured the services of Buck Consultants as the actuary for the State of Alaska Public Employees' Retirement System (PERS), Teachers' Retirement System (TRS), Judicial Retirement System (JRS) and the National Guard and Naval Militia Retirement System (NGNMRS). Buck replaces Mercer Human Resource Consulting, which had been the division's actuarial consultant for over 25 years.

Buck Consultants initially replicated the 2004 valuation prepared by Mercer in order to validate the assumptions used in preparing the 2004 Actuarial Report. The replication shows that Buck's results matched the Mercer results closely for TRS, but that Mercer understated the healthcare benefits in the PERS valuation. Other differences in both systems were a "wash." The employer contribution rate for TRS would have essentially been the same, but the PERS employer contribution rate would have been 30.37% instead of 28.19%.

Buck Consultants will next conduct an experience analysis - a periodic study of assumptions in relation to past and expected future experience - to determine whether the assumptions continue to be valid or if changes should be made. The study will cover fiscal years 2002 to 2005. This study will be presented to the board at its September meeting. Assumption changes approved by the board will be incorporated into the next valuation (June 30, 2006).

Senate Bill 141 required the board to procure a second actuary to annually review health cost assumptions prepared by the state's actuary and, not less than every four years, review plan assumptions prepared by the state's actuary. The board has contracted with Gabriel Roeder Smith & Company (GRS) to review and certify the assumptions used by the state actuary. GRS is currently reviewing the assumptions underpinning the 2005 Actuarial Valuation prepared by Buck Consultants, and will also review the assumptions in the experience analysis when available in June.

Through this process, the board is confident that the statutory requirements for actuarial services are met and the best practices are established in carrying out the board's fiduciary obligations for the state's retirement systems.

3. *Recommendations for additional legislative or administrative policy to improve the financial health of the retirement plans*

The board reiterates and updates the two recommendations presented in the previous report as follows:

(a) No enhancements to benefits to the PERS or TRS defined benefit plans for at least two years. Previously, the board recommended a one-year moratorium on benefit enhancements until it received updated actuarial information. Given that the funding ratio for the systems has declined further, and the long-term recommendations in this report, if enacted, will take some time to impact the unfunded liability, this moratorium should be extended. An exception to this recommendation would be if there was convincing evidence that passage of proposed legislation will result in an improvement in the financial condition of the fund.

(b) Index the beneficiary health deductible in the new defined contribution plan to increase commensurate to increases in the cost of living. Health care costs represent a substantial component in the under funding of the defined benefit plans. Even though beneficiaries will be responsible for a larger proportion of their health care cost under the new plan, health costs will continue to be a significant cost item in the new plan. Given that the Alaska Constitution provides that retirement benefits cannot be diminished, it is important that the benefit that is available to a member at retirement is the same as what was intended when the member was hired. The board recommends that the administrator issue a health plan booklet for the new plans that indexes all relevant stipulated dollar amounts to the Anchorage CPI. The Division of Retirement & Benefits is working closely with the health plan consultant at Buck Consultants to accomplish this objective.

4. *Short-term and long-term recommendations for addressing the unfunded liability of the retirement plans*

The board deferred long term recommendations until updated actuarial assumptions were completed. The board heard a preliminary report from the state actuary in March, but the additional experience analysis report and certification by the second actuary will not be presented until the fall. The board will not receive detailed actuarial data for each employer until June, but believes that it is in the best interest of the retirement systems to address the under funding of the systems with a short-term recommendation for the FY07 budget process, and a long term plan formulated to be in place for the FY08 budget cycle. These recommendations are set forth in Section IV of this report. The board reiterates its support for the following short-term and long-term recommendations presented in its previous report:

(a) Short-Term Recommendations:

(1) Create new health plan for new hires after June 30, 2006. It is the board's recommendation that the Division of Retirement & Benefits work closely with Buck Consultants and its health specialists to create a new retiree health plan for new hires with benefits comparable to what retirees have today, but with benefits indexed appropriately to ensure that dollar defined coverage does not become too expensive for beneficiaries to sustain and that the plan liabilities do not increase at an unsustainable rate. While this will not impact the unfunded liability of the prior defined benefit plans, this is intended to avoid a future unfunded liability in the new defined contribution plan.

(2) Implement a preferred provider program in communities where possible. Preferred provider programs save money for the beneficiary and for the plan. It is the understanding of the board that the state active employee and retiree health plan have a preferred provider program, which is compulsory for active employees and voluntary for retirees. While the absence of multiple providers in many of our communities will limit widespread implementation, the board believes preferred provider programs should be implemented to the extent possible.

(3) Continue to aggressively promote the use of generic drugs. It is the understanding of the board that the administrator, prior boards, retiree groups and health plan administrators have promoted the use of generic drugs and that the program has been successful. Estimates are that for every one percent of generic drug use, the plan saves \$1 million. Given that medical cost represents a large component of the unfunded liability and that the use of prescription drugs is increasing, it is the view of the board that the administrator and the board explore additional ways to promote the use of generic drugs.

(4) Implement other cost containment initiatives. The board has established a number of committees to investigate how to make the retirement plans operate more efficiently. Among the items the committees are likely to consider are: hospital and doctor preferred provider organizations, enhanced member outreach, paying for hospice care reimbursement, substitution of over the counter drugs for prescription drugs, formulary programs, education of members, education of physicians, and negotiated drug prices. Because the committees are just beginning their work, the board will endeavor to implement other cost containment initiatives as they become known.

(5) Establish procedures for the periodic review of the eligibility of retiree dependents.

The Division of Retirement and Benefits completed the first eligibility verification project for all retirees covered under the AlaskaCare Plan. Dependents include spouses and children up to age 23 if they are enrolled full-time at an accredited

educational or technical institution. Retirees provided documentation that supports dependent eligibility. The estimated savings is approximately \$16 million annually.

The retiree health plan is a qualified plan in accordance with Section 401 (h) of the tax code. Medical benefits for retirees, spouses and dependents as defined by the Internal Revenue Code, are tax-free. Eligibility audits are conducted on health plans for two reasons: (1) ensure compliance with federal tax laws and (2) to reduce claims costs to the health plan. The board encourages the division to maintain plan compliance with the Internal Revenue Code through eligibility verification audits and in order to manage health care costs by establishing a review process to be conducted at regular intervals in the future.

(b) Long-Term Recommendations:

(1) Consider extending the pay-off period for the liabilities. Currently the calculations for employer contribution rates are based on a payment schedule of 25 years. A shorter payoff of the liability is desirable, but not mandatory. Given that projections indicate employer contribution rates as high as 50% of payroll, it may be in the best interest of the citizens of Alaska to assure that funds are available to meet the obligations to public employees, but also to pay for them at a sustainable level. A longer payback period may reduce the employer rate such that impacts on services are minimized. The board has requested the actuary to provide actuarial calculations of various amortization schedules.

(2) Request contributions to systems. Buck Consultants has reported to the board that the combined unfunded liability of the PERS and TRS has grown to \$6.9 billion. Since the state is expected to have a large budget surplus this year, the board recommends that the legislature make substantial contributions to the systems in order to increase the funded status and dampen the impact increased contribution rates will have on employers across the state in FY2007 and into the future. The board also recommends the legislature pass legislation that will promote annual budgeting of funds to address the past service liability.

(3) Adopt a funding strategy that will set a limit on the rate of employer contributions. This strategy will be linked to the first two strategies. It is recommended that full funding be provided annually. This recommendation is intended to be applied in combination with the strategy to extend the payoff period similar to a home mortgage. The board intends to explore combinations of employer contribution rates and payoff periods.

(4) Additional Actuarial Data. The board received the preliminary 2005 valuation data at its March meeting, and is expecting an additional report on the experience analysis that the consultant is currently undertaking. Evaluation of the assumptions and any recommendations for changes in assumptions will be reviewed by the board at its September meeting.

(5) Pension Obligation Bonds. The board received information on pension obligation bonds as a potential tool to assist employers in reducing exposure to unfunded accrued actuarial liabilities. The board will continue to assess the fiscal, practical and legal issues regarding issuance of such bonds by or for the benefit of public employers.

5. *Recommendations for legislative procedures regarding fiscal notes for new legislation affecting the retirement plans*

Alaska statutes provide guidance for preparation of fiscal notes for bills and resolutions introduced in the legislature. AS 24.08.035 relates to all bills and resolutions introduced in the legislature and has applicability to retirement legislation. AS 24.08.036 relates specifically to bills affecting the state retirement systems.

AS 24.08.036. *Fiscal notes on bills affecting state retirement systems.* Before a bill which would have an effect on the retirement systems of the state is reported to the rules committee, there shall be attached to the bill an analysis of the long-term and short-term costs to the state if the bill is adopted, as well as the impact of the bill on the actuarial soundness of the fund. The analysis is in addition to the fiscal note requirements of AS 24.08.035.

In many cases, the Division of Retirement and Benefits must use the division's actuary in order to provide fiscal notes on bills that would affect the retirement systems. The division's actuary requires time and resources in order to prepare a fiscal analysis on various bills. In order to comply with AS 24.08.036 and the time lines found in AS 24.08.035, the board recommends that bills affecting the retirement system be submitted as early in the legislative session as possible. This will allow the actuary the necessary time to prepare a comprehensive analysis, the Alaska Retirement Management Board the opportunity to review and make recommendations on proposals, the municipalities time to review the impact of proposals and the legislature more time to hold public hearings.

In addition, the board recommends that fiscal note legislation include the following:

- a) if a bill provides for enhanced benefits, cost estimates should include a high and low case scenario based upon the percentage of members electing to take advantage of the enhanced benefits;
- b) the dollar amount of the unfunded liability increase or decrease if the proposal was enacted, as well as the percent change in employer and/or employee contributions;
- c) identification of revenue sources to cover ongoing costs to the system;
- d) information on unfunded liability, and that any excess accrued liability over the assets of the plan constitutes annual payments for 25 years in order to amortize the unfunded liability;

e) certification that the costs and revenues have been developed in accordance with generally accepted actuarial principles; and

f) any fiscal impact to individual employers.

B. Other Senate Bill 141 Requirements

1. Defined Contribution Plan

The defined contribution plan becomes mandatory to all new entrants as of July 1, 2006. It is a plan in which employer and employee contributions are accumulated in individual accounts and invested by the members for the exclusive benefit of the members. Contribution provisions are established by State law and may be amended only by the State Legislature. The plan also includes some defined benefit features, such as occupational death and disability benefits. It also includes provisions for a retiree medical program and individual health reimbursement arrangement (HRA) accounts.

The Alaska Retirement Management Board is the fiduciary for the defined contribution plan and is responsible for selecting investment options and investment managers. The investment options for the defined contribution plan were selected to provide broad exposure to the risk/return spectrum and to allow for diversification across several asset classes. Generally, higher potential return investments have a higher degree of risk as measured by volatility of returns.

The investment managers went through a rigorous hiring process and are high quality firms with significant institutional business. All firms are either investment advisors registered with the Securities and Exchange Commission or bank/trust companies. All investment options and managers will be monitored on an ongoing basis by the board, investment staff, and consultants.

The following table provides information with respect to the investment options for the defined contribution plan and is arranged from highest potential risk and return to lowest.

	INVESTMENT OPTION	OBJECTIVE	① INVESTMENT TYPE ② MANAGEMENT STYLE ③ MANAGER
Higher Risk / Higher Return ↑	Brandes Institutional International Equity Fund	To provide long-term capital appreciation. The Fund invests principally in common and preferred stocks of foreign companies and securities that are convertible into such common stocks.	① International Stocks ② Actively managed ③ Brandes Investment Partners, L.P.
	T. Rowe Price Small-Cap Stock Trust	To achieve long-term capital growth by investing primarily in stocks of companies in the Russell 2000 Index, a widely used benchmark for small-cap stock performance.	① Smaller company common stocks ② Actively managed ③ T. Rowe Price Associates, Inc.
	Citizens Core Growth Fund	To achieve long-term capital appreciation while investing in companies that are managed in a socially responsible manner.	① The fund invests in the companies that make up the Citizens Index, a proprietary index designed to serve as a benchmark for socially responsible investing. The Citizens Index TM consists of approximately 300 primarily large-cap companies. ② Actively managed ③ Citizens Advisers
	S&P 500 Stock Index Fund	To provide income and capital appreciation matching the total return of the Standard & Poor's 500 Composite Stock Price Index.	① All 500 of the equity securities in the S&P 500 Index, in proportion to the size of each as measured by its total market value ② Passively managed ③ State Street Global Advisors
	Alaska Target 2025	To provide a diversified mix of stocks, bonds, and cash for long-term investors with a higher tolerance for risk. The fund is designed to gradually invest more conservatively, with an emphasis on capital preservation, as the year 2025 approaches.	① Large- & Small-Cap stocks, international stocks, government & corporate bonds, mortgages, and money market instruments. ② Combination of Enhanced Index (Passive), Structured-Active, and Actively Managed Portfolios. ③ T. Rowe Price Associates, Inc.
	Global Balanced Fund	To achieve balanced long-term growth of capital, current income, and conservation of principal through investments in stocks and fixed-income securities.	① Stocks of large and small companies and corporate & government bonds based around the world ② Actively managed ③ Capital Guardian Trust Company
	Alaska Long-Term Balanced Fund	To provide a balanced and diversified mix of stocks, bonds, federally guaranteed mortgages, and money market instruments for investors with an average risk tolerance.	① Stocks of large & small U.S. & established international companies, investment-grade U.S. bonds, federally guaranteed mortgages, and money market instruments ② Combination of Enhanced Index (Passive), Structured-Active, and Actively Managed Portfolios. ③ T. Rowe Price Associates, Inc.
	Alaska Balanced Fund	To provide a balanced and diversified mix of stocks, bonds, federally guaranteed mortgages, and money market instruments for investors with a low to average risk tolerance.	① Stocks of large & small U.S. & established international companies, investment-grade U.S. bonds, federally guaranteed mortgages, and money market instruments ② Combination of Enhanced Index (Passive), Structured-Active, and Actively Managed Portfolios. ③ T. Rowe Price Associates, Inc.
	Government/Corporate Bond Fund	To meet or exceed the return of the Lehman Brothers Government/ Credit Bond Index.	① Investment-grade fixed income securities represented in the Lehman Brothers Government/ Credit Bond Index. ② Actively managed ③ State Street Global Advisors
Lower Risk / Lower Return ↓	Short-Term Interest Fund	To preserve principal, offer current income, and provide liquidity.	① Cash equivalent instruments with maturities less than one year including commercial paper, banker's acceptance, certificates of deposit, obligations of the United States Government and its agencies, and repurchase agreements collateralized by US Treasury instruments ② Actively managed ③ T. Rowe Price Associates, Inc.

2. Health Reimbursement Arrangement Plan

Senate Bill 141 establishes the Health Reimbursement Arrangement Plan to allow medical care reimbursement from individual savings accounts of eligible persons. Employers shall contribute an amount equal to three percent (3%) of the employer's average annual employee compensation to the plan.

AS 37.10.220(a)(6) provides in part that the board shall establish the rate to annually credit interest to each member's account in the health reimbursement arrangement plan under AS 39.30.300 – 39.30.495. It also provides that the rate shall be adopted on the basis of the probable effective rate of interest on a long-term basis, and the rate may be changed from time to time.

The interest rate will be credited annually. It is not imperative that the board establish the crediting rate for the health reimbursement arrangement until June of 2007. In order to ensure that assets in the health reimbursement arrangement plan are equal to or greater than the sum of the individual accounts, the board will have to take into consideration the fact that plan assets will start the year at zero and grow with each contribution over the course of a year. Accordingly, the first year crediting rate is likely to be one-half of what the board would consider to be a reasonable crediting rate once the fund is mature.

3. Office of Administrative Appeals

The Office of Administrative Appeals is charged with hearing appeals by members of PERS and TRS. Appeals were formerly heard by either the Public Employees' Retirement Board or the Teachers' Retirement Board.

III. Alaska Retirement Management Board

A. Trustee Appointment

Senate Bill 141 established the Alaska Retirement Management Board consisting of nine trustees: the commissioner of administration and commissioner of revenue; two trustees from the general public who are not members or beneficiaries of the retirement system; one trustee employed as a finance officer for a political subdivision in either the public employees' retirement system (PERS) or the teachers' retirement system (TRS); two trustees who are members of PERS; and two trustees who are members of TRS.

Trustees must meet eligibility requirements for an Alaska permanent fund dividend and be professionally credentialed or have recognized competence in investment management, finance, banking, economics, accounting, pension administration, or actuarial analysis.

In early October, Governor Murkowski made the following trustee appointments: Gail Schubert and Martin Pihl (public members), Lawrence Semmens (finance officer), Samuel Trivette and Michael Williams (PERS members), and Gayle Harbo and John (Bob) Roses (TRS members). Commissioner of Administration Scott Nordstrand and Commissioner of Revenue William Corbus are ex officio members. John (Bob) Roses resigned his seat in March; he is a candidate for statewide office, and statute prohibits holding a seat while seeking statewide elective office.

B. Board Organization and Structure

Policies and Contracts. At the initial meeting of the Alaska Retirement Management Board October 11, 2005, the trustees adopted Resolution 2005-01, accepting fiduciary responsibility for the funds of the retirement systems and, on an interim basis subject to further review, the securities lending, custody, asset allocation, investment policies and contracts for external money managers and consultants of the Alaska State Pension Investment Board.

Committees. Committees are established to monitor ongoing investment programs, and also provide governance, compliance and problem solving. Committees of the board, generally comprised of three to five trustees, provide an opportunity for in depth and detailed oversight in fulfilling the responsibilities assigned to the trustees as fiduciaries of the funds. Committees take no action on behalf of the board; the committee role is to advise and recommend. Ad Hoc or temporary committees are sometimes named to facilitate a manager search or to complete a time-sensitive project. Committee meetings are open to the public and board members may attend any committee meeting in person or by teleconference.

Investment Advisory Council. Senate Bill 141 provides that the board may appoint an Investment Advisory Council comprised of at least three but no more than five members. At the initial board meeting, the trustees approved by motion the staff recommendation that the Investment Advisory Council be maintained, and that the contracts with the three current members, Dr. Jerrold Mitchell, Timothy M. O'Brien, and Dr. William Jennings, be continued.

IV. Legislative Action

The board acknowledges that it is late in the legislative session for consideration of additional appropriation legislation, and appreciates the endeavors of legislators, committees and staff to address the unfunded liability. However, it is in the best interest of the retirement systems for the legislature to address the under funding of the systems in both the fiscal year 2007 and 2008 budget process, or the unfunded liability will very likely grow larger. The board offers the following recommendations, listed by priority for action by the legislature. These recommendations, both short- and long-term, address employer concerns with escalating contribution rates and the growing actuarial shortfall of the retirement systems.

A. Priority 1: Establish Past Service Retirement Liability Accounts

This funding plan is patterned after the school debt reimbursement program (AS14.11.100), with annual appropriations from FY2008 going forward for PERS and TRS employers. This proposed legislation for the PERS and TRS funds is the board's first priority and consideration during this legislative session is requested so that funding can be included in the FY08 budget cycle. The particulars for each fund are set forth below, with proposed legislation attached as appendices.

1. *The Public Employees' Retirement System Past Service Retirement Liability Account*
 - Establishes the Public Employees' Retirement System Past Service Retirement Liability Account in the Department of Revenue
 - Provides for a method to calculate a specific annual amount to be included in the Governor's budget.
 - Is applicable to political subdivision and school district employer members of PERS
 - Provides incentives for employers to pay down their unfunded liability
 - Anticipates that the ARMB would set the employer contribution rate at the actuarially required rate

The calculated amount to distribute shall be based on the total eligible payroll reported to the department of administration by the employer during the fiscal year three years earlier and either the average past service cost rate of all employers in the system during the fiscal year three years earlier, or the employer's past service cost rate during the fiscal year three years earlier, less 5%, whichever is lower.

In order to provide incentives to employers to pay down their unfunded liability the amount shall be increased by 50% of the amount an employer paid to the system during the fiscal year three years earlier that was in excess of what the employer was required to pay to the system.

See Appendix 1 – Proposed Legislation

Public Employees' Retirement System Past Service Retirement Liability Account

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2. *The Teachers' Retirement System Past Service Retirement Liability Account*
 - Establishes the Teachers' Retirement System Past Service Retirement Liability Account in the Department of Revenue
 - Provides for a method to calculate a specific annual amount to be included in the Governor's budget.
 - Is applicable to TRS employers
 - Anticipates that the ARMB would set the employer contribution rate at the actuarially required rate

The calculated amount to distribute shall be based on 85% of the total eligible payroll reported to the department by the employer during the fiscal year three years earlier and the past service cost rate of the system during the fiscal year three years earlier of the teachers' retirement system.

See Appendix 2 – Proposed Legislation

Teachers' Retirement System Past Service Retirement Liability Account

B. Priority 2: Appropriation for Increased Political Subdivision Employer Costs

In 2005 the legislature, through Senate Bill 46, provided funding for the increase in fiscal year 2006 contribution rates that political subdivisions were required to pay. Although it is late in the current legislative session for proposing additional appropriation legislation, without state aid, most political subdivisions will absorb a 10% increase in rates. The board recommends that the state fund one-half of the approximate \$37.2 million increase, or \$18.6 million. This would have the state and municipalities sharing 50/50 of the increasing PERS costs. This recommendation does not impact the actuarial shortfall because total contributions are less than the actuarially required contributions.

See Appendix 3 – Proposed Legislation

Appropriation for Increased Municipal Employer Costs

C. Priority 3: Legislative Appropriation to Fund Actuarially Required Contribution

According to projections for FY07, to fully fund the retirement systems the actuarially required contribution is \$461 million for PERS, and \$261 million for TRS. The projected actual contribution for PERS using the adjusted employer rates is \$351 million, a difference of \$110 million. The projected actual contribution for TRS is \$163

million, a difference of \$98 million. Without funding the actuarially recommended rates, the unfunded liability will continue to grow.

See Appendix 4 – Proposed Legislation

Legislative Appropriation to Fund Actuarially Required Contribution - PERS

See Appendix 5 – Proposed Legislation

Legislative Appropriation to Fund Actuarially Required Contribution - TRS

APPENDIX 1

[Priority 1]

**The Public Employees' Retirement System
Past Service Retirement Liability Account**

Sec. ____ AS _____ is amended by adding a new section to read:

Sec _____. **State aid for past service retirement benefit liability costs.** (a) During each fiscal year, the state shall allocate to an employer that is a municipality or school district member of the Public Employees' Retirement System the following sum:

- (1) Payments to the retirement system anticipated to be made by the employer during the fiscal year for the retirement of past service liability of the employer to the Public Employees' Retirement System.

(b) The commissioner of revenue shall administer the program of distribution authorized under this section and shall provide by regulation a procedure for calculating the amount of distribution to which an employer is due, and other regulations necessary to administer the program. The payment to the employer shall be based on the total eligible payroll reported to the department of administration by the employer during the fiscal year three years earlier and either the average past service cost rate of all employers in the system during the fiscal year three years earlier, or the employer's past service cost rate during the fiscal year three years earlier, less 5%, whichever is lower.

(c) The payment provided in (b) of this paragraph shall be increased by 50% of the amount an employer paid to the system during the fiscal year three years earlier that was in excess of what the employer was required to pay to the system.

(d) The Public Employees' Retirement System Past Service Retirement Liability Account is established. Funds to carry out the provisions of this section shall be included within the appropriation bill submitted by the governor under AS 37.07.020(a) (2) and may be appropriated annually by the legislature. If amounts in the account are insufficient for the purpose of providing the share to which an employer is entitled under this section, those funds that are available shall be distributed pro rata among the eligible employers.

(e) Funds in the Public Employees' Retirement System Past Service Retirement Liability account which exceed the amount required for the payments authorized in this section revert to the general fund at the end of the fiscal year for which the money is appropriated.

(f) If an employer receives more state aid than it is entitled to receive under this chapter, the employer shall immediately remit the amount of overpayment to the commissioner, to be returned to the Public Employees' Retirement System Past Service Retirement Liability account.

(g) If an employer receives state aid under this chapter in excess of the employer's past service liability, the employer shall immediately remit the amount of overpayment to

the commissioner, to be returned to the Public Employees' Retirement System Past Service Retirement Liability account.

Sec. _____. Definitions. In this chapter, unless the context requires otherwise,

- (1) "total eligible payroll" means the payroll reported to the department on which employer contributions are required.
- (2) "average past service cost rate" means the past service cost rate of all employers as reported by the actuary for the fiscal year three years earlier.
- (3) "commissioner" means the commissioner of the department of revenue.

Sec. _____. Effective Date. Effective for 2008 budget cycle.

APPENDIX 2

[Priority 1]

**The Teachers' Retirement System
Past Service Retirement Liability Account**

Sec ____ . AS _____ is amended by adding a new section to read:

AS _____ **State aid for past service retirement benefit liability costs.** (a) During each fiscal year, the state shall allocate to an employer, other than the state, that is a member of the Teachers' Retirement System the following sum:

(1) Payments to the retirement system anticipated to be made by the employer during the fiscal year for the retirement of past service liability of the employer to the Teachers' Retirement System.

(b) The commissioner of revenue shall administer the program of distribution authorized under this section and shall provide by regulation a procedure for calculating the amount of distribution to which an employer is due, and other regulations necessary to administer the program. The payment to the employer shall be based on 85% of the total eligible payroll reported to the department by the employer during the fiscal year three years earlier and the past service cost rate of the system during the fiscal year three years earlier of the teachers' retirement system.

(c) The Teachers' Retirement System Past Service Retirement Liability Account is established. Funds to carry out the provision of this section shall be included within the appropriation bill submitted by the governor under AS 37.07.020(a) (2) and may be appropriated annually by the legislature. If amounts in the account are insufficient for the purpose of providing the share to which an employer is entitled under this section, those funds that are available shall be distributed pro rata among the eligible employers.

(d) Funds in the Teachers' Retirement System Past Service Retirement Liability account which exceed the amount required for the payments authorized in this section revert to the general fund at the end of the fiscal year for which the money is appropriated,

(e) If an employer receives more state aid than it is entitled to receive under this chapter, the employer shall immediately remit the amount of overpayment to the commissioner, to be returned to the Teachers' Retirement System Past Service Retirement Liability account.

Sec. ____ . **Definitions.** In this chapter, unless the context requires otherwise,

- (1) "total eligible payroll" means the payroll reported to the department of administration on which employer contributions are required.
- (2) "average past service cost rate" means the past service cost rate of all employers that have a past service liability.
- (3) "commissioner" means the commissioner of the department of revenue.

Sec. ____ . **Effective Date.** Effective for 2008 budget.

APPENDIX 3

[Priority 2]

Appropriation for Increased Municipal Employer Costs

Sec. _____. Retirement system funding for increased employer costs for political subdivisions. (a) The sum of \$18,581,921 is appropriated from the general fund to the Department of Administration to reduce the liability to the public employees' retirement system of political subdivisions that are members of that system, in order to reduce the increased employer costs resulting from fiscal year 2007 employer contribution rate increases. The Department of Administration shall allocate the appropriation to the public employees' retirement system account of each political subdivision resulting from fiscal year 2007 employer contribution rate increases, as set out in this section. The appropriation made by this subsection is intended to reduce these increased employer costs.

For purposes of allocating the appropriation made by (a) of this section to the public employees' retirement system account of each member political subdivision, the allocation is as follows:

AKUTAN, CITY OF	16,941
ALEUTIANS EAST BOROUGH	33,915
ALLAKAKET, CITY OF	3,056
ANCHORAGE, MUNICIPALITY OF	6,913,262
ANDERSON, CITY OF	2,149
ATKA, CITY OF	4,628
BARROW, CITY OF	47,355
BETHEL, CITY OF	282,716
BRISTOL BAY BOROUGH	81,472
CORDOVA, CITY OF	112,553
CRAIG, CITY OF	74,603
DELTA JUNCTION, CITY OF	13,507
DENALI BOROUGH	7,889
DILLINGHAM, CITY OF	110,426
EGEGIK, CITY OF	2,830
FAIRBANKS NORTH STAR BOROUGH	929,023
FAIRBANKS, CITY OF	333,653
FORT YUKON, CITY OF	24,209
GALENA, CITY OF	95,984
HAINES BOROUGH	85,814
HOMER, CITY OF	248,456
HOONAH, CITY OF	35,299
HOOPER BAY, CITY OF	1,576
HUSLIA, CITY OF	5,215
JUNEAU, CITY AND BOROUGH OF	1,397,093
KACHEMAK, CITY OF	1,193
KALTAG, CITY OF	870
KENAI PENINSULA BOROUGH	702,515

KENAI, CITY OF	235,223
KETCHIKAN GATEWAY BOROUGH	214,696
KETCHIKAN, CITY OF	400,460
KING COVE, CITY OF	50,001
KLAWOCK, CITY OF	31,917
KODIAK ISLAND BOROUGH	118,047
KODIAK, CITY OF	314,368
KOTZEBUE, CITY OF	169,920
KOYUK, CITY OF	1,664
LAKE AND PENINSULA BOROUGH	19,656
MATANUSKA-SUSITNA BOROUGH	583,491
MEKORYUK, CITY OF	611
MOUNTAIN VILLAGE, CITY OF	1,786
NENANA, CITY OF	12,244
NOME, CITY OF	123,946
NOORVIK, CITY OF	12,352
NORTH POLE, CITY OF	80,525
NORTH SLOPE BOROUGH	2,006,956
NORTHWEST ARCTIC BOROUGH	44,779
PALMER, CITY OF	154,333
PELICAN, CITY OF	7,657
PETERSBURG, CITY OF	206,671
QUINHAGAK, CITY OF	1,920
SAINT PAUL, CITY OF	74,829
SAND POINT, CITY OF	38,396
SAXMAN, CITY OF	5,637
SELDOVIA, CITY OF	2,405
SEWARD, CITY OF	186,026
SITKA, CITY AND BOROUGH OF	439,010
SKAGWAY, CITY OF	89,301
SOLDOTNA, CITY OF	136,756
TANANA, CITY OF	7,302
THORNE BAY, CITY OF	10,435
TOKSOOK BAY, CITY OF	583
UNALAKLEET, CITY OF	11,157
UNALASKA, CITY OF	520,772
VALDEZ, CITY OF	250,819
WASILLA, CITY OF	228,380
WHITTIER, CITY OF	49,904
WRANGELL, CITY OF	132,606
YAKUTAT, CITY AND BOROUGH OF	36,178

APPENDIX 4

[Priority 3]

**Legislative Appropriation to Fund Actuarially
Required Contribution - PERS**

Section _____ Retirement system funding to bring fiscal year 2007 contributions closer to actuarial rate. (a) The sum of \$109,836,677 is appropriated from the general fund to the Department of Administration to reduce the contribution shortfall to the public employees' retirement system resulting from an employers anticipated fiscal year 2007 contribution being less than the fiscal year 2007 rate calculated by the actuary. The Department of Administration shall allocate the appropriation to the public employees' retirement system account of each employer as follows:

ALASKA, STATE OF	66,452,622
ALEUTIANS WEST CRSA	978
ALLAKAKET, CITY OF	4,883
ANCHORAGE PARKING AUTHORITY	21,070
ANCHORAGE SD	3,388,980
ANCHORAGE, MUNICIPALITY OF	14,116,880
BRISTOL BAY BOROUGH	69,577
BRISTOL BAY BOROUGH SD	30,321
CHATHAM SD	42,576
CHUGACH SD	25,258
COPPER RIVER SD	49,787
CORDOVA CITY SD	104,731
CORDOVA COMMUNITY MEDICAL CENTER	37,587
CORDOVA, CITY OF	262,023
CRAIG CITY SD	16,897
CRAIG, CITY OF	28,200
DELTA/GREELY SD	36,430
DENALI BOROUGH	19,581
DENALI BOROUGH SD	67,666
DILLINGHAM CITY SD	17,944
DILLINGHAM, CITY OF	35,336
EGEGIK, CITY OF	11
FAIRBANKS NORTH STAR BOROUGH	243,404
FAIRBANKS NORTH STAR BOROUGH SD	1,274,328
FAIRBANKS, CITY OF	5,938,351
HAINES BOROUGH	67,621
HOMER, CITY OF	444,736
HOONAH CITY SD	3,007
HOONAH, CITY OF	6,636
HUSLIA, CITY OF	5,820
HYDABURG CITY SD	12,806
JUNEAU BOROUGH SD	310,143
JUNEAU, CITY AND BOROUGH OF	2,294,026

KACHEMAK, CITY OF	5,705
KALTAG, CITY OF	5,135
KENAI PENINSULA BOROUGH	827,562
KENAI PENINSULA BOROUGH SD	1,181,731
KENAI, CITY OF	524,077
KETCHIKAN GATEWAY BOROUGH	210,402
KETCHIKAN GATEWAY BOROUGH SD	125,090
KETCHIKAN, CITY OF	377,233
KING COVE, CITY OF	800
KODIAK ISLAND BOROUGH	420,248
KODIAK ISLAND BOROUGH SD	312,519
KODIAK, CITY OF	733,106
KUSPUK SD	52,049
LAKE AND PENINSULA BOROUGH	7,862
LAKE AND PENINSULA BOROUGH SD	50,153
LOWER YUKON SD	366,532
MATANUSKA-SUSITNA BOROUGH	378,102
MATANUSKA-SUSITNA BOROUGH SD	704,008
NOME, CITY OF	206,246
NORTH PACIFIC FISHERY MGMT COUNCIL	4,038
NORTH POLE, CITY OF	103,877
NORTH SLOPE BOROUGH SD	39,506
NORTHWEST ARCTIC BOROUGH SD	10,554
PALMER, CITY OF	172,544
PELICAN, CITY OF	567
PETERSBURG CITY SD	30,787
PETERSBURG, CITY OF	43,814
SAINT PAUL, CITY OF	5,537
SAND POINT, CITY OF	36,707
SAXMAN, CITY OF	7,982
SEWARD, CITY OF	205,373
SITKA BOROUGH SD	219,700
SITKA COMMUNITY HOSPITAL	69,453
SITKA, CITY AND BOROUGH OF	509,252
SKAGWAY CITY SD	12,046
SOLDOTNA, CITY OF	166,295
SOUTHEAST ISLAND SD	123,765
SOUTHEAST REGIONAL RESOURCE CENTER	29,559
SOUTHWEST REGION SD	31,368
UNALAKLEET, CITY OF	3,325

UNIVERSITY OF ALASKA	4,904,632
VALDEZ CITY SD	300,052
VALDEZ, CITY OF	563,340
WHITTIER, CITY OF	5,489
WRANGELL PUBLIC SD	54,982
WRANGELL, CITY OF	263,355

APPENDIX 5

[Priority 3]

**Legislative Appropriation to Fund Actuarially
Required Contribution - TRS**

Sec. _____ . Retirement system funding to bring fiscal year 2007 contributions closer to actuarial rate. (a) The sum of \$ 98,670,780 is appropriated from the general fund to the Department of Administration to reduce the contribution shortfall to the teachers' retirement system resulting from an employers anticipated fiscal year 2007 contribution being less than the fiscal year 2007 rate calculated by the actuary. The Department of Administration shall allocate the appropriation to the teachers' retirement system account of each employer as follows:

ALASKA DEPARTMENT OF EDUCATION	755,610
ALASKA GATEWAY SD	403,338
ALEUTIAN REGION SD	53,610
ALEUTIANS EAST BOROUGH SD	434,978
ANCHORAGE SD	31,080,150
ANNETTE ISLAND SD	257,550
BERING STRAIT SD	1,764,485
BRISTOL BAY BOROUGH SD	123,319
CHATHAM SD	169,010
CHUGACH SD	161,607
COPPER RIVER SD	404,773
CORDOVA CITY SD	313,449
CRAIG CITY SD	376,667
DELTA/GREELY SD	600,749
DENALI BOROUGH SD	353,802
DILLINGHAM CITY SD	438,146
FAIRBANKS NORTH STAR BOROUGH SD	9,664,455
GALENA CITY SD	704,214
HAINES BOROUGH SD	238,315
HOONAH CITY SD	168,485
HYDABURG CITY SD	117,656
IDITAROD AREA SD	273,013
JUNEAU BOROUGH SD	3,676,927
KAKE CITY SD	119,663
KASHUNAMIUT SD	279,614
KENAI PENINSULA BOROUGH SD	6,136,593
KETCHIKAN GATEWAY BOROUGH SD	1,653,943
KLAWOCK CITY SD	172,363
KODIAK ISLAND BOROUGH SD	2,203,895
KUSPUK SD	422,303
LAKE AND PENINSULA BOROUGH SD	649,593
LOWER KUSKOKWIM SD	3,759,830
LOWER YUKON SD	1,911,109
MATANUSKA-SUSITNA BOROUGH SD	10,161,431

NENANA CITY SD	244,134
NOME CITY SD	514,346
NORTH SLOPE BOROUGH SD	2,331,648
NORTHWEST ARCTIC BOROUGH SD	2,101,730
PELICAN CITY SD	20,744
PETERSBURG CITY SD	450,716
PRIBILOF SD	134,814
SAINT MARY'S SD	126,607
SITKA BOROUGH SD	1,174,120
SKAGWAY CITY SD	117,102
SOUTHEAST ISLAND SD	253,734
SOUTHEAST REGIONAL RESOURCE CENTER	134,813
SOUTHWEST REGION SD	854,893
SPECIAL EDUCATION SERVICE AGENCY	154,318
TANANA SD	51,103
UNALASKA CITY SD	440,981
UNIVERSITY OF ALASKA	6,934,933
VALDEZ CITY SD	704,644
WRANGELL PUBLIC SD	284,908
YAKUTAT SD	123,263
YUKON / KOYUKUK SD	726,339
YUKON FLATS SD	328,945
YUPIIT SD	457,301