**State of Alaska**
**ALASKA RETIREMENT MANAGEMENT BOARD**
# ACTUARIAL COMMITTEE MEETING

**Downtown Marriott Hotel**
**Skagway-Yukon Boardroom**
**820 West 7th Avenue**
**Anchorage, Alaska**

**April 22, 2015**

## ATTENDANCE

**Committee Present:** Kristin Erchinger, *chair*
Tom Brice
Commissioner Sheldon Fisher
Gayle Harbo
Martin Pihl
Sam Trivette

**Committee Absent:** None

**Department of Revenue Staff Present:**
Pamela Leary (Treasury Division director)
Gary Bader (chief investment officer)
Judy Hall (board liaison)

**Department of Administration Staff Present:**
John Boucher (deputy commissioner)
Jim Puckett (chief operating officer, Retirement & Benefits Division) *on line*
Kevin Worley (chief financial officer, Retirement & Benefits Division)

**Others Present:**
Stuart Goering (Department of Law ARMB counsel)
David Slishinsky (Buck Consultants, actuary)
Leslie Thompson (Gabriel Roeder Smith, reviewing actuary) *on line*

## CALL TO ORDER
CHAIR ERCHINGER called the meeting to order at 9:05 a.m.

## ROLL CALL
All six committee members were present.

**PUBLIC MEETING NOTICE**
MS. HALL confirmed that public meeting notice had been met.

**APPROVAL OF AGENDA**
MR. BRICE moved to approve the agenda and MS. HARBO seconded. Without objection, the agenda was approved.

**PUBLIC/MEMBER PARTICIPATION, COMMUNICATIONS AND APPEARANCES**
There were no appearances or communications.

**REPORTS**

**A. Review Draft Charter/Recommendation to Board**
CHAIR ERCHINGER remarked that committee members had not had much time to review the draft charter and might wish to defer taking action until a later date.

CHAIR ERCHINGER said she thought it was important for the record to state why an Actuarial Committee was needed. After the Mercer lawsuit, the legislature created multiple levels of actuarial review, with the goal of never again using actuarial assumptions that were outdated and without sufficient peer review for accuracy. There is now the primary actuary and a reviewing actuary that reviews the assumptions in the actuarial report each year. The actuaries are also required to provide their peer reviews. There is a further review for the health care assumptions that are done more frequently than the other assumptions. Then an auditing actuary is contracted to do a review every four years.

CHAIR ERCHINGER said there is obviously a purpose behind the levels of review, but as long as she has been on the Board it seems those levels of review are sometimes just offered lip service. The Board has so much important work on which it focuses that it never has a fair opportunity to review the actuarial analysis in depth and weigh in on the results. As an example, GRS, the reviewing actuary, has made recommendations to the Board in the last two years that the Board has not acted upon. She felt the Board has not fully discharged its responsibility to consider the information from the reviewing actuary and then decide whether to incorporate it or not incorporate it. For her personally, the purpose of this committee is to give more attention to the actuarial work that is required of this Board that it has not found time to address during its meetings.

CHAIR ERCHINGER stated she has felt in the past that when the Board has asked for information of the actuaries it has not come back in a timely manner, not because the actuary did not produce the information but because the actuary had no mechanism by which to give that information directly to the Board. The information went to someone else, who then decided when to provide it to the Board. She stressed that it is not a matter of blaming somebody for holding up information but simply a matter of having full access to the actuaries that the ARMB is charged with hiring, in concert with the Department of Administration, and having that information in a timely manner so the Board can act upon it. She said she was not interested in micro-managing the actuaries or getting between the actuaries and their work with the departments. She felt the Board should give fair time to the actuaries and review actuaries that produce work on behalf of the ARMB, take into account the information they provide, and be able to give the actuaries feedback on what direction the Board feels they should go.

<u>MS. HARBO moved to adopt the Charter of the Actuarial Committee and forward it to the full Board for approval</u>. <u>MR. BRICE seconded</u>.

MS. HARBO said she found the charter complete, and if any additions were needed, the committee could always amend the charter later. She would be more comfortable adopting the charter at this meeting.

COMMISSIONER FISHER said that he was concerned about how the charter and the Department of Administration staff functions worked together, and he had expressed as much to the Chair before the meeting. He had reached out to the Board's counsel, Stuart Goering, to ask if he had reviewed the charter in light of the statutory authority that is given both to the ARMB and to the Department of Administration. He did not think there had been time for that review to happen. He recommended tabling approval of the charter until there was time, from a statutory and legal perspective, to look at the responsibility of the Board and the responsibility of the department so they are aligned in a way that is rational and appropriate.

MS. HARBO recalled that the areas of responsibility regarding the actuaries were reviewed quite some time ago, when Mike Barnhill worked in the Department of Law, and there should be a record of that. MR. TRIVETTE said that legal review took place in 2006.

COMMISSIONER FISHER said he had spoken to Mr. Barnhill, who shared that memorandum with him. Mr. Barnhill had told him that the memorandum was presented to, but not adopted by, the full Board. Regardless, Mr. Barnhill's view is that the memorandum and this charter are not completely consistent. The commissioner said that is why it would be helpful to have enough time to review the charter and think about the committee's and the department's respective statutory responsibilities and to make sure that they are aligned in an appropriate way.

MR. PIHL spoke on why there was a need for an actuarial committee. One reason was the statute under which the Alaska Retirement Management Board was created. Like the Chair, he did not believe in micro-managing the work in the Department of Administration (DOA) as it crossed lines with the Board. However, he has had a number of observations of actuarial work over the years where he has found fault with it. He has asked for corrections and mostly they have not been done. Specifically, the actuary's level dollar analysis stops employer contributions two years short at mid-2031, which then overstates state assistance contributions, something he found to be plain wrong. More recently he compared the DOA payroll numbers with the payroll used in the Buck projections and found either a $60 or $90 million overstatement of PERS and an understatement of TRS going into a 25-year projection. Starting with that big a discrepancy and compounding it over 25 years will result in a big problem. He said he spoke to Buck's Dave Slishinsky about this, and he understood the payroll difference would be corrected in today's presentation.

MR. PIHL said he intended to ask some questions further in the agenda that he thought would support the need for the ARMB to have more interaction with the actuary. However, given how the whole thing works now, in terms of how and when funding occurs, and how little the ARMB has to say on the actual funding, he was thinking the board ought to go back to being the investment board. He was getting tired of the confrontations that occur from his genuine efforts to see that things are right and to face the unfunded liability without such a high cost to the state and the municipalities.

In response, CHAIR ERCHINGER stated that it was a perfect example of why this committee was so important, because in fairness to the actuaries, she knew that Mr. Slishinsky was going to prepare the reports that Buck is asked to prepare and that the data contained in those reports is going to be accurate based on his professional work. But if someone asks Mr. Slishinsky to include or not include an assumption, such as the $90 million payroll difference that Trustee Pihl mentioned, that will determine the presentation of that information. The point of this committee is to review actuarial assumptions: the committee may want to see a presentation with different assumptions, and the ARMB has not had the ability to do that in the past. She noted that Mr. Pihl's expression of frustration is shared by some other trustees who feel that sometimes it is a battle they do not want to be fighting. The ARMB needs information to make the decisions, and having access to the actuaries to get that information will solve many of those frustrations.

MR. TRIVETTE said he concurred with the Chair's comments and most of those expressed by Mr. Pihl. He said he had attended some meetings of the previous Alaska State Pension Investment Board and some PERS and TRS board meetings. He also had read minutes from the 1990s leading up to the issue with Mercer because he had tried to figure out how that situation happened. He was part of the original ARMB that went through a day-long training session put together by staff and legal counsel, and also spent quite a bit of time working with Mike Barnhill on issues. He said that as a layperson he did not see anything in the draft Actuarial Committee Charter that was inconsistent with the memo that Mr. Barnhill wrote to the Board in 2006. He expected, however, that the committee might need to revise the charter in the coming months, which was normal for other committees as well. He mentioned that under previous administrations the Board was restricted in what information it would get from the actuary, which he found intolerable. The ARMB has a legal, moral and statutory obligation, as fiduciaries of the retirement systems, to make sure it gets the best possible information, including looking at the data in more than one way at times to get a better picture. He concluded by saying that unless counsel believed that there was a legal issue with the charter, he was in favor of going forward with the charter today. Staff has done a superb job of capturing some of the frustrations that have come out over the last decade, and the document was well done. He felt the most important part of the charter was that the committee would have direct access to the actuaries, but the Board understands that the actuary has other responsibilities than providing the annual valuations. He pointed out that six trustees out of nine were on this committee, indicating the concern of people that the process is done right.

CHAIR ERCHINGER explained that she spent a lot of time looking at the statutes to make sure that the draft charter reflected what was in the statutes, and she doubted there was much room for legal dispute except perhaps in the wording. She wanted everyone to have the best intentions to work together in the interest of full disclosure and for the committee to have the information the ARMB is supposed to get from the actuaries.

MS. HARBO thanked the Chair for working on the draft charter and for tying the charter in with the committee meetings and specifically saying which areas of the charter apply. She added that the ARMB lacks an independent legal counsel since Rob Johnson retired, and that was a resource the Board should have. There was nothing in the draft charter that caused her heartburn, and she thought the committee should adopt it today. Then Mr. Goering would have time prior to the next committee meeting to review the charter and report any issues at that time.

COMMISSIONER FISHER stated that he did not believe that anyone in the administration or the department had any concerns about the concept of the Actuarial Committee, and he did not have any concerns about the issues that had been highlighted. He proposed, rather than adopting the committee charter today and having to rework it later, to get the legal review work done by early May to have a full understanding of the various statutory requirements and mandates on the different organizations, and then provide written recommendations for proposed changes to the charter, if any.

MS. HALL clarified that the format for committee motions of this type is to recommend that the ARMB approve the charter for the committee.

As maker of the motion, MS. HARBO agreed with the verbiage, and MR. BRICE, as second, also concurred.

<u>In response to the Chair's question if he wanted to make a motion, COMMISSIONER FISHER moved to table action on the draft charter of the Actuarial Committee</u>. (It was determined that no second was required on a motion to table.)

On a roll call vote, the motion failed, two votes in favor, four against.

The committee then addressed the main motion that the committee recommend to the full Board approval of the charter of the Actuarial Committee. The roll was called, and the vote was 5-1 in favor, with Commissioner Fisher being the dissenting vote.

MR. TRIVETTE said the full Board should be told that the commissioner had wished to table the charter. He said he was totally open to the commissioner following up on better wording or other changes that the committee could take up at the May meeting. He suggested that any proposed changes be given to committee members far enough in advance to adequately review them before the meeting.

CHAIR ERCHINGER indicated that she would include that in her report to the Board.

**B. FY14 Valuation Update – Timelines**
**Discussion of Presentation – Format and Content**

CHAIR ERCHINGER recalled that since legislation passed to change the nature of the contribution rate setting it has put pressure on the actuaries, and she was interested in discussing the timeline and hearing what kind of pressure that imposes on the ARMB.

DAVID SLISHINSKY of Buck Consultants stated that the retirement systems – PERS in particular, but also TRS – are challenging because they are complicated. There are numerous tiers of benefits, there are pension benefits and healthcare benefits, and there are full-time employees and part-time employees. There is something called an indebtedness that has to be taken into consideration in the valuation, and he has never done a valuation before that used an indebtedness situation to value some of the liabilities. For people who have terminated, are vested, and who took a refund, the actuary values them as if they are going to be rehired and will put their money back to reinstate their prior service. Plus, the actuary does a full 30-year deterministic forecast for these valuations as well.

Regarding the indebtedness factor, COMMISSIONER FISHER asked if that meant that the State of Alaska is unusual in allowing rehires to repay any refunds they took and reinstate their pension benefit.

MR. SLISHINSKY replied that it is an unusual practice to consider that in the valuation. Typically, for a person who was refunded, Buck would just not value them anymore. It is not uncommon to give people who were refunded, when they are rehired, a window of opportunity to reinstate their prior service by paying back their refund.

CHAIR ERCHINGER asked if that was simply an assumption that Buck was making in its valuation or whether statute allows the people to come back in and therefore that is why Buck is valuing it that way. MR. SLISHINSKY responded that statute allows them to come back in, but that is the case in other retirement systems as well. Buck makes the assumption that they will not hold any liability for those people because they got their money back. And if they do come in and they put their money back, there could be an actuarial loss because the value of the benefit that they are going to receive is greater than the amount of the refund.

COMMISSIONER FISHER asked if Buck was valuing it the way they are because the state has instructed them to do that or because Buck, in its professional judgment as an actuary, has chosen to do that. MR. SLISHINSKY replied that it was done by the prior actuary, and he thought there was a section of statute that refers to the indebtedness. So it is a practice of the Alaska plans because of statute, and that is unusual. It is not that the indebtedness in particular makes it a difficult valuation, but it is the combination of everything.

MR. TRIVETTE inquired if it was a common occurrence in Alaska for people to be rehired and pay back the money they took out. MR. SLISHINSKY said he did not know and would have to look at the data to see if any data fields record that occurrence. MR. TRIVETTE said he guessed that it was not super-common but he could be wrong, and if it was a common occurrence then he wanted to make sure to continue to do it.

MR. SLISHINSKY stated that, in addition to time and effort taken on the valuation to make sure that all of the processes the actuary goes through to value the different tiers of pension and healthcare benefits are performed properly, they have to get the data in order to start. Buck's work is dependent upon getting that data, which basically starts the clock running on their process for doing the valuation. Once they get the data, they go through a process of screening and matching records to the prior data so they track what happens to everybody. The number of questions that arise because of that screening dictates how much time the valuation process is going to take. The current timing has always been set up for Buck to present the results at the April board meeting.

CHAIR ERCHINGER commented that at that point the assumptions that Buck has made are already in the valuation. She assumed that Buck, to a large degree, was making those assumptions based upon industry standards but questioning whether they want to assume this or that.

MR. SLISHINSKY gave some examples of missing or questioned information that Buck has to follow up on once they receive the data. They request this information during the data processing period of the valuation in the effort to be very accurate. They consider if the results would be materially different if they used a reasonable assumption to fill in that information instead of having staff go back to each employer for the missing pieces of data. The auditors' process is auditing the census data that Buck uses, and the question always seems to be about whether or not any differences are going to be material. In many cases, it is not going to be material, but there can be a case where something is material. It is a matter of judgment about what could or could not be material and how to deal with the information going forward. A lot of time can be spent on doing the data processing that includes refining the data and getting it as accurate as possible.

Deputy Commissioner JOHN BOUCHER explained that one obligation the Department of Administration has is to provide the Office of Management & Budget with the state assistance payment amount for the budget. Normally they try to do that in the mid-November time frame. Prior to HB385, there was more time for the ARMB to contemplate. After passage of the legislation, DOA was in an accelerated time frame that everyone found very uncomfortable. Regarding Mr. Slishinsky's explanation of the actuary's time spent on data, he thought that at some point in time the department had to provide a number based on the best information at hand that met the intent of that legislation. It meant not having perfect data because there was not time to do all the data scrubbing that potentially could have been done in a longer time frame. He said that if the intent going forward is to change the overall timeline to meet that particular deadline, then it may mean backing up to see what the department is actually capable of and what the expectations should be. There may be a point where the department has to say that the data is as good as it gets at this point, and then, going forward, having an adjustment that is done essentially after the fact. He understood that that was not unusual for other plans.

Chief investment officer GARY BADER noted that Mr. Slishinsky had said that more than likely these were not material changes that would affect the contribution rate. He reminded the committee that one assumption is the investment earnings for the previous year, and that number is not available in time to meet the Office of Management & Budget deadline. The CIO made an estimate of what the earnings would be, which was plugged into the contribution rate calculation. Any estimate made by a CIO is more than likely to completely subsume any minor error that is made in the data for 70,000 people. He said it is important that the ARMB's recommendation be what is provided to OMB for the contribution rate because it is what the statute anticipates. Recognizing that there are assumptions made is the preferable way to go.

MR. PIHL remarked that he could not see that the projections for two years out would actuarially change that much from year to year.

CHAIR ERCHINGER said she agreed with Mr. Bader's remarks that the CIO's earnings assumption could have a bigger impact than most of the minor data changes that result from the actuary's data screening and matching process. She acknowledged that the reviewing actuary will discover and report any census data that is missing or not accurate and this will reflect on Buck. This conversation is important to help the ARMB trustees understand when these things happen. If the ARMB's goal is to focus on the largest opportunities for material error, then it will necessitate recognizing that some of the smaller things will not get any attention at all because there is no time.

MR. SHLISINSKY asked if there were any more questions or comments about the valuation timelines or the FY14 valuation.

CHAIR ERCHINGER stated that she would like to know what assumptions have the greatest likelihood of adversely impacting the outcomes if the actual experience were to vary significantly from the estimated assumption. Also, what areas the actuary has decided they do not have the time to look at because the issues are just not that material. The ARMB has said that it does not have an opportunity to weigh in on some of the large assumptions that have a material impact, and now there is less opportunity because of timing. If the committee at least knew what those large areas were and could have a conversation around them as early as possible, the trustees would have a lot more comfort with where things were heading. She said this could be a topic for a future meeting.

Regarding the valuation, MR. PIHL said he still wanted to get back to the payroll base because he thought it was one of the most important factors. He referred to page 30 of Buck's presentation that showed PERS 2014 defined benefit and defined contribution payroll at $2.358 billion, while the actual payroll number that the Division of Retirement & Benefits provided is $2.178 billion, a difference of $180 million. The same page showed a total payroll of $2.472 billion in 2016. On page 26, the total DB and DCR payroll used for the 2016 valuation is $2.436 billion, which is a difference of only $36 million. He said he was skeptical of the $2.436 billion payroll number for 2016 because of the $180 million difference in the 2014 total payroll number, which is used as the basis for 2016. An overstatement of total payroll at the beginning, extended out 25 years, will overstate the employer contribution by a huge amount. He said this was an example of why an ARMB committee should be looking at this type of detail. He asked that the PERS total payroll be proved up based on the actual payroll going in and not be different by $180 million.

CHAIR ERCHINGER asked Mr. Pihl if he had any objection to putting the topic of the payroll base and the payroll growth assumption on the agenda for the next meeting. MR. PIHL indicated that he looked forward to an answer at that time.

MR. SLISHINSKY explained that the 2014 valuation for FY15 uses the prior year's salaries provided by the Division of Retirement & Benefits. That would be total salaries from July 1, 2013 through June 30, 2014. Buck then increases the salaries with the salary scale to turn them from last year's salary to this year's salary. That is the salary that is used in the valuation for purposes of projecting forward future pension benefits that are based on final average salary. For part-time people the statutes require the pay to be annualized. Then the amount of the actual fractional service that is credited for the year there is an assumption for future fractional years of service for part-time people. So the focus in the valuation is accurately calculating expected future benefit payments based upon that payroll and the present value of what those benefits are for purposes of determining the accrued liability, the unfunded liability, and the normal cost amounts. When looking at the prior year and what the contributions were, and what the payroll for those contributions were, it will include people who were active at the beginning of the year (July 2013) and maybe they terminated in September 2013 or January 2014 or April 2014. It is a portion of the year. At the end of the year, for purposes of the FY15 pay, Buck does not include those people in the valuation as an active person because they are not active.

MR. PIHL remarked that it seemed the actuary should have two different payroll bases, one upon which benefits will be based and the other actual payrolls that contributions will come in on.

MR. SLISHINSKY agreed, saying that for the 2014 valuation Buck took a different pay for purposes of determining the FY17 contribution. They used unannualized part-time pay for those part-time people because the actual contributions coming in for 2015, 2016 and 2017 are based upon their actual pay and not their annualized pay. That reduced the salary for PERS about $95 million, and for TRS it reduced it about $10-$12 million. He added that the payroll numbers Mr. Pihl was citing were in the appendix as reference only.

CHAIR ERCHINGER observed that this type of misunderstanding happens often, and perhaps Buck could put a date on pages where the information has been presented previously. It can be hard to keep it all straight when leafing through a large volume of presentation pages.

MR. SLISHINSKY indicated that the agenda of today's presentation (slide 2) identified that the information in the appendix was presented in December 2014, so he had tried to clearly label it as prior year's information.

MR. PIHL said he hoped everyone understood the clear difference between the payroll base of what is going to come in (contributions) and what is going to go out to fund the benefits. CHAIR ERCHINGER thanked him for making that distinction clear.

MR. SLISHINSKY said they should discuss the process and the use is of that salary number. Further on he wanted to go through the roll forward methodology so that everybody sees what the pieces are, what Buck is doing, how it is calculated, and then how Buck gets to the projected unfunded liability in order to determine the contributions for FY17. He reminded everyone that the fiscal year 2017 being discussed right now starts July 1, 2016, which is over a year from now, and then goes to June 30, 2017. Right now Buck is just trying to guess as to what that salary is going to be, in order to determine what those contribution rates ought to be right now. He said he felt like a weather forecaster being asked to forecast the weather for FY17, not the weather for next week. He had made a presentation at last February's board meeting showing projections that he had said were not a prediction but were calculations based upon the adopted assumptions, or an expected occurrence of what is going to happen. It is not a premonition or a guarantee that it will happen in FY17 or FY31 or FY39. Actuaries cannot predict the future any more than the ARMB can, but they use mathematical analysis for the purpose of saying "it is reasonable to assume *this* will happen." It puts the systems on a path to funding. And it is known that every valuation is going to have actuarial gains and losses. Actuarial gain or loss is the difference between what the actuary expected to happen and what actually did happen. The whole valuation process over time is self-correcting because the actuary does a valuation every year: when something they thought was going to happen doesn't happen, or vice versa, they make the change and get the system back on the path.

MR. SLISHINSKY assured Mr. Pihl, regarding the $180 million difference in the PERS payroll number for 2014, that Buck had changed their payroll number for 2016. He explained that while the change they made was $36 million, there are other issues that this committee can discuss with regards to the assumptions on the salary, especially for this purpose.

CHAIR ERCHINGER requested adding that discussion to the next agenda. She asked if it was possible to get information about how well the payroll growth assumptions have been met over the last ten years. She was curious about what is happening with payroll growth as a result of the defined contribution plan being initiated, in particular if defined benefit employers cannot get qualified people and have to increase the salary in order to attract and retain people because the retirement plan is not as robust. She wondered if there were higher-than-expected payroll increases as a result of that. Added to that is what is coming down the pipe for Alaska's economy in the future and how that will potentially play into the payroll growth assumption.

MR. PIHL remarked that the Division of Retirement & Benefits (DRB) has a report for seven years on the total PERS and TRS salaries that contributions were made on.

MR. SLISHINSKY said there are two elements of the salary increase: the pay increase for each continuing member, and then the added increase due to any new members being added each year.

CHAIR ERCHINGER encouraged putting off this discussion until next meeting and continuing with today's agenda. MR. PIHL requested that the CFO of DRB provide the schedule he was referring to for the next meeting packet. MR. BRICE said he thought that information was already outdated and not relevant.

## C. Review of Prior Actuarial Work

Methodology for Elimination of Lag in the Contribution Rate

MR. SLISHINSKY said he made some revisions to the December presentation to meet the agenda under the review of the prior actuarial work. Then, through some emails with the chair, he added the roll-forward procedure based on the preliminary 2014 valuation results that the Board has not seen yet. He had the reviewing actuary GRS look at the material, and he believed they had opined that it was consistent with what Buck had done in the past and this process is an acceptable method for rolling forward the liabilities.

MR. SLISHINSKY reviewed the legislative intent to eliminate the two-year contribution lag. Buck recommended doing the roll-forward and to use the most accurate and up-to-date information when the contribution rate is adopted by the Board and sent to OMB. For this year that includes audited fund balances as of June 30 if they are available within the timeline that is required to meet the state's requirements. If not, then roll forward the fund balances using investment rates of return reported by FY15, even if they are not final, much like was done last year when Buck rolled the return rate forward at 17.7%. The investment return estimate was rounded down to be conservative. Buck could do something similar to that later this year, if the audited balances are not available in time.

CHAIR ERCHINGER remarked that there is a big lag between when year-end fund balances are available and when the audited fund balances are done. While Buck would prefer to have audited balances, she thought that preliminary balances were ready before that. The actuary could use the preliminary balances to compare against what they would get when rolling forward the prior year to give an order of magnitude of how close they are.

MR. SLISHINSKY said the first bit of information Buck may get is on the rate of investment return for the year. After that, they may get preliminary asset balances from DRB that can be used. If Buck gets audited statements, that is what they would like to use, but those may not be available until after the state's deadline for getting a contribution rate or amount.

MR. SLISHINSKY explained that on the asset side Buck will use the best information available as of June 30, 2015, and then they will roll forward those assets to June 30 of 2016, assuming an 8.0% investment return. The accrued liabilities determined and measured in the 2014 valuation will be rolled forward two years, first from June 30, 2014 to June 30, 2015, assuming no demographic gains or losses, and then from 2015 to 2016. Once they have an accrued liability at June 30, 2016, and they have an estimated asset value as of June 30, 2016, that means they have an estimated unfunded actuarial accrued liability at 2016 that they can then amortize.

MR. BRICE asked if there was an ability to review the demographics in that rollover period if something very dramatic happens. MR. SLISHINSKY said maybe but normally not because Buck does not collect the data. They will collect the data on the June 30, 2015 valuation around late August into September, and that information will not be of use in time for the rollover purpose, typically. MR. BRICE asked if there would be some other point in time as Buck goes through the valuation process where if there is a dramatic action they could take that into consideration. MR. SLISHINSKY said there could be, for instance in salary: what if there is a large drop in active members because the members that are leaving are not being replaced. Those kinds of dramatic changes could occur in one year. That information would have to come out of the data processing work done on the 2015 valuation. The big question is whether Buck could get anything out of that before contribution rates and amounts need to be reported to OMB for budget purposes.

MR. BOUCHER said he thought it would be a big challenge. He added that this is a self-correcting process that is done every year. He said that once into this mode, ultimately we will be able to react to the underlying demographics in a much more nimble way than we would have previously. In the past, it could have taken two cycles to recognize a dramatic change in either direction. That is now one cycle, and that will increase the credibility of what the ARMB puts forward.

MR. SLISHINSKY stated that once the fund values are rolled forward Buck could estimate the unfunded liability as of June 30, 2016 that could then be amortized for purposes of determining the FY17 contribution rates. In addition, when Buck does a deterministic forecast, they are forecasting the normal cost (the dollar cost of the accruing benefits for active members) to FY17 in the projection process. So they can use that for the normal cost in determining the FY17 contribution amounts and rates. HB385 set the amortization period at a closed 25-year period beginning June 30, 2014, so by 2016 that is over a 23-year period. Buck takes the rolled-forward estimated unfunded liability and amortizes it over 23 years, and that gives an annual amount of the payment for FY17, which they then can add to the normal cost at FY17 to give a total contribution amount for FY17. Buck then takes that amount and divides it by the estimated payroll for FY17 to get rates. (He had earlier described the revised payroll number that takes into account the salary of part-time members differently.)

MR. BRICE asked, if the result of the calculation was dramatic decreases in payroll, if that would start to balloon the unfunded liability. MR. SLISHINSKY responded that the amount of the required contribution is determined as an amount and not as a rate, and Buck does that first. The employers are contributing on a capped 22% of salary basis. If the salary is actually lower, then that means the contribution on the 22% coming in to pay that amount is less, which increases the amount of additional state contribution. He added that there are some other dynamics with regards to defined contribution plan (DCR) people that he would get into later.

MR. SLISHINSKY next described the new roll-forward procedure for PERS to June 30, 2016 (slides 5 and 6) to determine the contribution rates and amounts, and the state assistance amount, for FY17.

CHAIR ERCHINGER said if the interest accruing on the PERS unfunded liability is $1.6 billion in FY15, trustees will do the quick math in their heads and compare that to the interest earnings of $1.2 billion to say how much further the system got behind this year because there were not sufficient assets in the fund. She asked if that was a fair assessment.

MR. SLISHINSKY said it is fair to look at the investment rate of return, provided that it is net of expenses, and, assuming an 8.0% annual return, say that if it is 6% one year then the unfunded liability is going to go up, and if the return is 10% one year then the unfunded liability is going to go down. If the earnings rate is 8.0%, then the unfunded liability is going to change as expected, particularly when amortizing over an increasing payroll, depending upon how long of a period being looked at. If the time period was sufficiently long, one could expect the unfunded liability to increase, even with the expected contributions and an earnings rate of 8.0%, because it is as a level percentage of pay and pay increases to make those payments. That is the theory behind the methodology.

CHAIR ERCHINGER asked if it was then fair to say that if the ARMB hit its earnings target of 8.0% every year PERS would be going backwards $400 million each year.

MR. PIHL remarked that it would get worse every year because the unfunded liability would grow during the next eight to ten years because of the level percent of pay method.

CHAIR ERCHINGER said that was a different issue.

MR. SLISHINSKY said it was part of the contribution. He added that if the contributions were enough to pay the normal cost, and enough to pay interest on the unfunded liability, and then actually pay a little principal on the unfunded, then the contributions would be paying for some of that interest that is not being received in the assets because the liability is greater, and you are being charged on the interest on the liability. That is if the contribution is sufficient to at least pay the interest on the unfunded. If level percentage of pay method is used, and the period for funding is sufficiently long, it is very possible that the contributions being made to amortize the unfunded liability are not even enough to cover the interest, so that interest portion in the contributions plus the expected rate of return or interest on the assets is not sufficient to cover the interest on the accrued liability.

MR. TRIVETTE said he wanted the actuary to set that forth so it is clear to understand. It would help trustees when answering questions from members.

CHAIR ERCHINGER agreed, saying it was helpful information to demystify that piece. It would be great if there was a way to simplify it further in the future.

MR. SLISHINSKY stated that one of the difficulties with doing the valuation has always been the time lag and the fact that the contributions coming in were based on a rate of pay that was two years before.

MR. SLISHINSKY continued presenting the new roll-forward procedure for PERS. The unfunded liability at June 30, 2016 is equal to the expected accrued liability of $22.4 billion as of 2016 minus the expected actuarial value of assets at 2016 of almost $17 billion. So that unfunded liability is a bit more than $5.4 billion. And the funded ratio, by taking the 2016 asset value and dividing it by the 2016 actuarial accrued liability, is 75.7%. In 2014 the funded ratio was 70.1%. Just a few years ago it was in the low sixties. The investment return from 2010 through 2014 has been greater than 8.0%, and the $1.0 billion contribution to PERS last year has $400-$500 million that is going directly to pay down the unfunded liability.

MR. SLISHINSKY remarked on the number of changes that have been made over the past year, including the legislature contributing $3.0 billion to PERS and TRS in the 2014 session and making other changes, and then an experience analysis that changed the assumptions.

COMMISSIONER FISHER commented on the drop in the PERS unfunded liability from $6.358 billion at June 30, 2015 to $5.453 billion at June 30, 2016, and questioned whether the difference could all be attributed to a higher actual investment return.

MR. SLISHINSKY said that in the 2014 valuation there is a proposed change in the healthcare cost trend rates that is reducing the healthcare liability. So part of the difference is the demographic gains and losses. Buck adopted the updated healthcare rates from the Society of Actuaries model that they use, which are long-term in nature, and then graded in rates over the short-term into those long-term rates as part of a proposed change in the healthcare cost rates for the 2014 valuation. That is another reason why the PERS unfunded liability is less. That information will be in the June presentation to the Board.

CHAIR ERCHINGER requested that Mr. Slishinsky cover the other retirement plans in summary, having delved into great detail on the PERS roll-forward procedure.

Wrapping up on PERS, MR. SLISHINSKY reviewed the calculation for contribution rates, amounts, and additional state assistance for FY17. He went into detail on how the salary amounts are determined for the contribution amount, describing how there is a shift from defined benefit to defined contribution members over time so that the DB salary is starting to come down as those members leave the plan and are replaced by DCR hires.

MR. PIHL remarked on the drop in state assistance for PERS in FY17 to $79 million compared to $126 million in FY16. MR. SLISHINSKY said part of what is dropping the amount is the change in the healthcare cost trend rates.

CHAIR ERCHINGER said the analogy of stepping over a dollar to pick up a penny came to mind again, looking at the gyrations in the last few years. It begged the question of the difference between looking at a global perspective of a funding strategy versus looking at how each little piece of the actuarial assumptions is parsed out and how and when those are implemented. Many people were surprised to see the significant rate decline year over year that occurred from not just the $3.0 billion injection by the legislature but also the other legislative changes it made in HB385 and SB112. She said it seemed as she saw the declines based on one single year's change in a particular actuarial assumption that it was being disingenuous to the overall magnitude of the problem by not taking some different kind of approach. Year over year, the ARMB will see huge increases and decreases. She was trying to figure out how to honor the intent of the legislature, which is to use level percentage of pay, while still maintaining the trustees' fiduciary obligation. She could not really reconcile those two things, and she thought that was the frustration trustees were having.

MR. SLISHINSKY said it was how to reconcile the objectives on the one hand to have a level percentage of pay contribution into a pension system that is subject to a lot of volatility, and the Board trying to make decisions to ensure that the benefits security is maintained for the members of the retirement system. It is conflicting objectives at times.

MR. PIHL confirmed with MR. SLISHINSKY that Buck's full report in June will include projections out to year 2040. MR. PIHL said the projections will show the unfunded liability growing significantly for about ten years until the state assistance starts coming back up. He felt it was all due to using percentage of pay.

Referring to slide 6 (the exercise of running the FY17 estimated employer and state actuarial contributions and the estimated actual state contribution), CHAIR ERCHINGER asked it was possible to run the same exercise using the full plan out to about 2040 to give the committee an idea of what it would look like theoretically if level dollar were used instead of level percentage of pay. This year the estimated rate for additional state contribution is 3.28%. Perhaps it will get to where the rate has to be much larger, but she wondered what the average rate would be for the additional state contribution.

MR. SLISHINSKY responded that using a level percentage of pay approach and running it out to

2040 produces a rate that is fairly level between 3% and 4%. Also, even though the unfunded liability does increase, it is expected to increase until about 2022 before it starts getting paid off. When the amortization period is sufficiently long, it runs into a situation of negative amortization, where the amortization calculation is not even sufficient to pay interest on the unfunded. That is what causes the unfunded to expect to go up. But at the same time that the unfunded liability is getting larger, the funded ratio is increasing too because the assets are growing faster than the accrued liability. If one did that on a level dollar amount, the unfunded liability would always be decreasing. The funded ratio would increase faster, but since the funding periods are exactly the same, they reach 100% funding at exactly the same time.

CHAIR ERCHINGER said the 3% is really a result of the 22% contribution rate cap for PERS employers.

The Chair said the committee would skip over the TRS portion of the presentation and close this agenda item. She called a 10-minute break at 11:00 a.m. and reconvened the meeting at 11:10 a.m.

CHAIR ERCHINGER asked Leslie Thompson of GRS, who was listening by telephone, if she wished to make any comments on the discussion prior to the break.

MS. THOMPSON said GRS concurred with the overall methodology for the roll-forward last December. However, GRS has not completed the peer review yet. She still had some questions on the material that was sent to her to review on the roll-forward that she needed to submit to Mr. Slishinsky. The questions are generally about why some numbers do not match from one page to another, and she did not want to give the impression that she had gone through all the numbers and they were totally set in her mind. She would have everything ready for the June meeting.

MS. THOMPSON stated that she had some lingering questions about market value of assets versus actuarial value of assets. She was also going to bring forward questions on level dollar versus level percent of pay. The caveat is that she is not an attorney interpreting the statute, but she was finding it curious about going back to actuarial value of assets after a year, but staying at level percent of pay after a year. She is trying to understand how the new statute is getting implemented going forward.

MS. THOMPSON said that many times people set policy not knowing all the unintended consequences. So when she hears that the legislature sets a policy for level percent of pay she does not know that the legislators know what that means in terms of not getting to the principal on the unfunded liability. She liked the suggestion that somebody made today to return with a schedule that highlights how the unfunded liability is negative amortization (growing) as a result of level percent of pay amortization. That gets into the area that Mr. Slishinsky mentioned of putting at risk benefits security because the unfunded liability is not getting paid off as quickly as otherwise. The other interesting thing would be to show that if the amortization had stayed at level dollar it would save money over time – it is a matter of having the money to be able to save the money. A little bit like shopping at Costco.

MS. THOMPSON reminded the committee that last year she was concerned about and discussed with the Board that healthcare was looking like it was more expensive than it actually was. There had been a long discussion about there being margin in the method, and that the Board wanted that margin. So she was surprised when reviewing the valuations to see a change in the healthcare projection through the changes in the healthcare cost trend rate, etc. that Mr. Slishinsky talked about earlier. She looked forward to speaking about that so that the ARMB understands about decreasing the cost of healthcare in the valuation because of experiencing gains in the system from healthcare was what she expected at last year's conversation. Last year the position was about wanting that margin, and now it looked like the Board did not want *that* much margin, so she thought she should readdress it because it sounded like mixed messages.

CHAIR ERCHINGER thanked Ms. Thompson for those comments, which she found helpful in identifying the key points for the committee to spend more time on.

MR. BOUCHER asked if it would be fair to characterize the margin in the long-term healthcare projections that Ms. Thompson spoke about last year as a recommendation from GRS for the ARMB to address.

MS. THOMPSON said that when she reviewed the actuarial method and assumptions under healthcare there seemed to be what she called an embedded margin, meaning the contribution rates that get calculated are higher than what is needed. So every year the experience was big gains on the liabilities, which Mr. Slishinsky mentioned earlier. She said the ARMB needs to address whether it wants to change that approach: last year it felt like the Board was adamant that it really liked having that margin and those big gains every year. Now she was hearing a different answer, and Buck indicated they would change those rates and decrease some of those future gains. It is not that she is opposed to that, but she wanted clarity over what she thought was a board policy last year. It is an item worth discussing.

MR. BRICE supported Ms. Thompson's recommendation that the ARMB delve into the healthcare cost trend projections a little bit deeper. There is a lot that goes into that, and he wanted to make sure the Board has a thorough vetting of what is really happening.

MR. SLISHINSKY explained that there was discussion that the system has been experiencing significant gains on healthcare each year because the increase in the actual healthcare claims has not been as much as what the healthcare cost trend rates are that Buck uses. Buck has adopted the Society of Actuaries model, and the Society of Actuaries revised long-term projections for healthcare rates, and Buck is suggesting adopting that. However, when looking at the experience, there still is margin. He said the recommendation would be to adopt the updated Society of Actuaries model but recognizing that it would be a reduction in the amount of the margin but not an elimination of margin in the model.

MS. THOMPSON said that was very much the discussion to have.

MS. HARBO said she had asked Mr. Slishinsky for the number of retirees in Tiers 1, II and III of PERS and Tiers I and II of TRS that are 65 years old or older and therefore eligible for Medicare. The cost to the Alaska systems drops significantly when people reach Medicare age. If the number of retirees on Medicare is increasing every year, she thought that would affect the healthcare cost trend for PERS and TRS.

MR. BRICE said that before he would be comfortable adopting any recommendation on the healthcare side the Board needs to look at what is driving those costs down: is it cost-shifting to Medicare, which is appropriate? Or is it being artificially deflated in some shape or form? Or what is at play in that?

CHAIR ERCHINGER indicated that a discussion about DCR healthcare was on the agenda, and she was wondering if the DCR health plan would have anything to do with the bigger margin in healthcare. She put the foregoing discussion on the list as a future follow-up topic.

MR. SLISHINSKY had one more observation about the roll-forward amounts that were discussed before the break. The funding percentage for PERS on slide 5 is 67.7% for pension and 88.7% for healthcare. For TRS (slide 7), the funding percentage is 77.1% for pension and 89.1% for healthcare. This is a reflection of all the gains that have been occurring on healthcare that has gotten the funded ratio unequal for pension versus healthcare. One question he had for the Board is whether or not it should have an objective of trying to get those funded ratios closer together going forward to make up for all the gains that have been occurring in healthcare. A bit of that was done when state assistance coming in was all allocated to pension. However, the gap between pension funding and healthcare is still over 20% in PERS and about 12% in TRS.

MS. HARBO recalled Mr. Slishinsky's first presentation to the ARMB around 2006 when the healthcare liability was about three times the pension liability. MR. SLISHINSKY said the healthcare liability at that time was growing at a faster rate. He added that the difference now is from the change in the healthcare cost trend rates and that the experience has not been to the level of healthcare cost increases.

MS. HARBO said the defined benefit plan has an aging population of retirees.

MR. SLISHINSKY said the assumptions have the utilization of healthcare going up for older retirees, so all of that should be baked into the numbers. The real key reason for the gain on healthcare is that healthcare costs are just not going up as much as Buck is assuming in the healthcare cost trend rates. He has looked at the rate of increase in just the payments for pension versus the rate of increase for healthcare. There is a lot of volatility in healthcare payments, but the analysis showed that overall from 2006 through 2014 the average rate of increase on the pension payments was 5.65% and the average rate of healthcare benefit payments was 5.75%. That tells him that the rate of increase is very similar for pension and healthcare, but for the assumptions the healthcare cost trend rates are much higher than inflation.

CHAIR ERCHINGER said this was a great dialogue, but it was necessary to move along to the next agenda item.

<u>Discussion on Legislative Intent and Asset Smoothing</u>
MR. SLISHINSKY stated that the two intents of legislation SB119 were to eliminate the two-year

contribution rate lag (discussed earlier) and to eliminate asset smoothing. The ARMB has used a five-year smoothing of market values for purposes of determining the actuarial value of assets that is then used to determine the unfunded liability. Asset smoothing is very common and used by most pension systems. Five years is probably the most common period for smoothing. GFOA(Government Finance Officers Association) recommended asset smoothing in 2009 as a best practice for funding purposes. From time to time, systems will revert back to a market value or a fair value of assets to re-measure the assets but oftentimes will continue the smoothing process. Because of the short-term volatility and the effect that it has on funding, Buck's recommendation would be to retain asset smoothing. Although the intent is to eliminate smoothing -- he could see the reason to mark to market or fair value, especially at the same time that the accounting rules are changing under GASB – the Board really needs to think about what impact it has on the funding of the system if it were to use fair value of assets for the actuarial value going forward.

MR. SLISHINSKY explained that the best way to try and measure what that volatility looks like is to use a process that runs through a repetitive scenario of "what would happen if" the assets earn something better than expected or something worse than expected. Then take that difference and either recognize all of it immediately under fair value of assets, or use a smoothing process that said anytime there is an increase or a decrease different than what was expected that it be recognized over a five-year period instead of recognizing it immediately. Buck just developed an asset/liability modeling tool that is straightforward and simple for them to use. Alaska's case is the perfect application of the modeling tool to run through scenarios of what would happen if the ARMB went to market value and what would happen if it kept five-year smoothing, to get a measurement of the volatility in the contributions.

Buck looked at what happens with the additional state assistance contribution, and also what happens to the employer contribution (the 22% of pay). MR. SLISHINSKY explained how to read the graph on slide 11. He said the model outcome shows the downside risk for using fair value of assets in the short term or five-year period. People need only think back to the financial crisis in 2009, when there was a large loss on the investments, and the ARMB was using five-year smoothing that only recognized 20% of that loss in 2009. But it also meant having to recognize 20% of the loss in 2010, 2011, 2012 and 2013. What was happening was each year, when the fund recognized that loss, it increased the unfunded liability a little bit more. If the ARMB were to use fair value of assets, the fund would have taken that hit totally in the first year and had to amortize that. Then the funding requirements would have shot up much more than had actually happened in 2009.

MR. BADER asked, if this presentation was based on the Callan model for the earnings assumption and standard deviation instead of the GEM model Buck uses, if the outcome would be less appealing. MR. SLISHINSKY replied that the 50$^{th}$ percentile contribution would be higher. He said he did not want the discussion to be about the trees but to be about the forest, and to show what would happen if there was volatility.

CHAIR ERCHINGER remarked that the ARMB is not looking at just the next five years. When projected out to the year 2040 in this format, it is somewhat misleading in showing the trend in additional state contributions because it is not really consistent with the ARMB's policies. She said it was unclear why Buck was using that time horizon and not a shorter period.

MR. SLISHINSKY replied that it was only looking at a 10-year period and not going out to 2040.

CHAIR ERCHINGER asked if it was correct that the scenario the committee was looking at had additional state contributions of $900 million in 2025. MR. SLISHINSKY said there was a 5% chance of that under this model, but he did not want the focus to be on the amount of state contribution but to be on the volatility. He added that at the 95th percentile it was anywhere from an increase in the additional state contribution to $216 million in 2017 up to $394 million in 2019. That was using the smoothing.

Referring to slide 13, MR. SLISHINSKY presented the additional state contribution under fair value of assets (no smoothing), and the amounts were $399 million in 2016, $483 million in 2017, and $517 million in 2017. That is the short-term risk. He said whatever model is used and whatever assumptions are used, there will be some deviation in the level of volatility in this time period, whether the ARMB uses five-year smoothing or fair value of assets.

CHAIR ERCHINGER commented that the results will hold true whether the retirement fund experiences significant gains in investments or significant losses – this shows significantly higher state contributions in the short term without smoothing. But if the retirement fund had just experienced a period of significant losses in the market it would be a totally different presentation. It was a good tool, but what it said is that there is lots of volatility by not smoothing.

MR. SLISHINSKY said that is the reason why systems use smoothing. Regarding existing gains and losses, the model starts at 6/30/2014 at fair value for actuarial and fair value, so it is starting at the same point. The model is showing what if the retirement fund used fair value for each year thereafter, and what if it went back to five-year smoothing and phased in that smoothing over the next five years. That is the question, and the model is a method for measuring what the answer is.

COMMISSIONER FISHER said he focused on the 50th percentile as being the average, and there the volatility is much less than seen in the 95th percentile. He asked if that was thinking about it the right way.

MR. SLISHINSKY said yes, because looking at the roll-forward of 8.0% earnings, if the actual return is very close to what is assumed, then there is not as much to have to smooth and there is not as great a difference between fair value and five-year smoothing. The difference is when there is short-term volatility either on the down side or on the up side.

CHAIR ERCHINGER stated that the Board wanted to weigh in on whether it should be smoothing or not smoothing, and whether the Board needs to follow legislative intent or not. That is a philosophical conversation to have. She personally believed that it would be a slam-dunk to do smoothing if the Board were dealing with a hypothetical actuarial best-practice. But the legislature changed that game by not following actuarial best practice and changing from level dollar to level percentage of pay amortization. She thought the Board needed to have these conversations about each of the major assumptions, but it also had to have a macro-level conversation about its fiduciary responsibility to fund the retirement system. Otherwise, the ARMB will keep getting out of the forest and bumping into trees and will not make much headway on the overall charge, which is to make sure there are sufficient funds in the system.

MR. BRICE remarked that the ARMB always needs to be sensitive to legislative intent and what the legislature would like to see and hope for. If it had been a substantial issue for them, they could have put it in law like they did with percent of pay. At the same time, trustees do themselves and the Board, and particularly the beneficiaries and the fund, a disservice by not having some level of conversation about this, giving it true consideration, and at least establishing public record that the legislature can look back and review as to why the ARMB looked at the concept of getting rid of smoothing and went some other direction. He said he was torn. There is clear statement of intent, which frankly sets up, more or less, a very strange and almost impractical process to make the state assistance calculations. The burden on the Departments of Revenue and Administration to try to work without the smoothing in trying to project out is a real problem. However, the ARMB owes it to the legislature to have a more in-depth conversation.

MR. PIHL stated that the legislative intent was very clear direction to the Department of Administration and the ARMB. To not follow it without discussion of how eliminating smoothing could work would be a terrible mistake. He thought there are two ways to recognize a gain or loss, and one is immediate and the other is to spread it over the remaining 25-year fixed period, and that smoothes itself. As an accountant, he viewed smoothing over five years as sort of setting up another set of books. He thought the legislature saw a problem and went to something because they were committed to taking care of this in 25 years. He hoped there was enough board agreement to support a resolution to direct the actuary to eliminate smoothing.

CHAIR ERCHINGER indicated that time had run out for this agenda item, and she directed staff to put it on the agenda for the May meeting. She passed over the next item on the agenda to take up a process to address and act upon the reviewing actuary's findings on a valuation report.

Prior Review Findings/Develop Method for Closure

CHAIR ERCHINGER requested that this discussion focus on hearing recommendations from the actuary and reviewing actuary on how this committee could best facilitate reviewing the findings in an actuarial report and then come to a decision about how to proceed with those findings so there is closure. The process has to allow the committee to weigh in once the reviewing actuary has reviewed the actuarial valuation report and still meet the timeline.

MS. THOMPSON said GRS reviews the actuary's valuation report and presents findings at a board meeting. The piece in the process that is still open is a disposition by the Board on whether it believes any changes should be made. She felt that over the years she has made recommendations, and Buck may respond that the changes are de minimus or there is no comment at all, so items remain open. She would like to see the Actuarial Committee look at each finding and act to recommend that something be done or to count something as de minimus and leave it alone. If each item had a disposition by the committee, she thought that was all that was required in order to put closure on the findings part of the review.

CHAIR ERCHINGER said that was great advice. She asked Ms. Thompson, for the next committee meeting in May, to excerpt her primary findings and those that she would like the committee to review. The committee would deliberate on those findings and try to come up with recommendations to forward to the full Board at the time the Board is actually reviewing and approving the assumptions.

MS. THOMPSON agreed to prepare that material for the committee.

COMMISSIONER FISHER asked that, if appropriate, the review actuary produce the list of findings she wants the committee to act upon, and then the primary actuary be given the opportunity prior to the May meeting to write up their comments. The committee can review both before coming to the meeting and be in a better position to make recommendations.

CHAIR ERCHINGER said that was a great idea. She thanked Ms. Thompson for participating in the meeting and apologized for cutting short her part of the agenda because of time.

Responding to MR. PIHL and the CHAIR, board liaison JUDY HALL reported that she had received the draft FY14 valuation prepared by Buck and provided to staff by the Division of Retirement and Benefits. She was waiting for the reviewing actuary piece, and the whole package should be going out to the Board next week so there was lots of time to review it. Some of that discussion would be able to take place at the committee meeting in May.

CHAIR ERCHINGER wondered if that timeline allowed the committee to make recommendations for modifications in time for the actuaries to make any changes.

MR. SLISHINSKY replied that it depends on the nature of the change. Sometimes there were recommended changes that Buck had deemed de minimus or that they agreed to, but they agreed to change for the next year and not in the current valuation. The process did not hold up the current valuation report from being distributed and the Board acting on it at the June meeting.

MR. PIHL asked if the Board needed to vote on smoothing at the meeting this week.

MS. HALL said there was nothing on the agenda for this ARMB meeting to cover that because the valuation that would include smoothing is not coming to the Board for approval until the June meeting. Regarding Mr. Slishinsky's point about there not being enough time to make changes to the current valuation, she said this year the committee got started later in the valuation process. Looking at the committee's calendar for the next year, the next cycle of the valuation would allow for reviewing the valuation at the April meeting, so earlier than this year.

MR. SLISHINSKY pointed out that the FY14 valuation does use fair value of assets as of June 30, 2014 as the actuarial value of assets. Even the roll-forward that assumed the 8.0% return projection rolling forward, when there is an 8.0% roll-forward then there is actual and expected returns being the same, therefore, the five-year smoothing number and the fair value number are the same for FY15 and FY16. It is only when there is a difference between expected return and actual return that fair value and the smoothing create different numbers.

CHAIR ERCHINGER said she understood the frustration, but the timing being what it is, the committee will have to defer to the schedule and do the best possible. In order to best utilize the time in May – because people are interested in a lot of issues – she wanted to take up the issues that are most time sensitive. It is hard to identify what those issues are because it may be too late to even address them. Another conversation about legislative intent and asset smoothing should probably be at the top of the list. Healthcare cost trend assumptions, because of the magnitude of that change, should be on the May agenda. Because of timing, that discussion may not have any impact into the process, but the committee is doing the best it can to meet the calendar at this point.

CHAIR ERCHINGER stated that less important for May's agenda, in terms of timing, are the defined contribution health plan and perhaps the payroll growth assumption, unless committee members had objections.

COMMISSIONER FISHER said that some of the discussion so far about the growth in the employee payments is less important, but he was concerned that the actuarial trend and the reality in the state are diverging and that it was something of higher importance.

CHAIR ERCHINGER indicated she agreed with that point. She added that if the committee could actually come to a conclusion on the macro perspective going forward, that might then inform how the committee proceeds with all the smaller, incremental assumption reviews. It is a big nut to crack. She asked committee members to give her any other suggestions for how to structure the agenda for May, and she would work with Ms. Hall to flesh that out before the next meeting.

MR. BOUCHER addressed the to-smooth-or-not-to-smooth question, saying that it appeared to him that probably the first critical time frame would be after the investment returns are set for this year. Then it is asking whether to take a percentage of that return or all of that return, and then the subsequent calculations. From what Mr. Slishinsky had said, he gathered it would be more of a summertime discussion.

CHAIR ERCHINGER said she understood that but had a bit of heartburn with it personally. Regardless of whether a person is on the side of having to set a state budget or on the side of trying to maximize input into the system, almost by default a person is going to pick the answer to that question, in the summer when it is known if there are gains or losses, based on whether you want to get more money in the system or whether you cannot balance the state budget. So having the conversation that late in the game sets the committee up for some significant tensions that can be avoided if the committee can have a more generic conversation about the philosophy as a whole.

MR. TRIVETTE stated that he felt the issue should be settled. It is a policy issue that the ARMB has known about and needs to deal with. The issue is long term and not just about this fiscal year.

MR. SLISHINSKY inquired if anyone knew what the comments under SB119 were. He wanted to understand more about what the legislative intent to eliminate smoothing was all about and why the legislature put this in legislative intent in SB119 and not as a requirement in HB385.

MR. BADER stated that both bills came out post-public comment in the legislative process, so if there was comment it could have taken place on the floor of either the house or the senate, but not in the committee process.

CHAIR ERCHINGER said that because the legislative intent to eliminate smoothing happened without open dialogue for the public this committee is really speculating about a lot of things. It has taken the ARMB a year to get enough information to really understand the impact of that legislative intent, so she was certain that no one in the legislature had any clear understanding of the impact of their own legislative intent. She said that with all due respect because many legislators work very hard to understand this type of thing. The ARMB trustees are fiduciaries, and the legislators clearly put legislative intent in SB119. Discussions around the table have included whether even the state administration is required to follow legislative intent and then how that impacts the ARMB. She said she was not clear about that.

MR. BRICE stated that the concept to eliminate smoothing came up from the legislature wanting to have the value of the retirement fund at a given point in time, without the calculations of past years' gains or losses. He knew that Buck had those two values done every year but they were not side-by-side in presentations. He thought it came down to the legislature's desire to know exactly to the penny what is in the bank right now, without a lot of calculation of last year's gains or losses or projections out to the future.

<u>Defined Contribution Health Plan</u>
This item was deferred.

**D. Further Meeting Schedule**
A draft schedule of committee meetings for 2015 and into 2016 was included in the packet. The Chair asked committee members to take the schedule with them and bring up any changes at the next meeting.

MS. HALL said staff was looking at the week of May 11 as a tentative time for the May committee meeting. She would email everyone to find out their availability for that time period and whether Anchorage or Juneau would be the best location.

<u>MR. BRICE moved to approve the Actuarial Committee meeting schedule as presented</u>. <u>MR. TRIVETTE seconded</u>.

MS. ERCHINGER explained that the meeting schedule mostly corresponds to the ARMB quarterly meetings, where committee meetings generally are held the day before the board meeting. The intent today was not to get into the specific topics on the agenda at each meeting as much as to have a schedule that meets the timeline of actuarial analyses and reviews.

MS. HALL pointed out that the meeting scheduled in May this year will happen in conjunction with the April board meeting in 2016. The only committee meeting that would be outside the board's meeting schedule would be the August meeting, which would be the pre-valuation conference to get in a discussion with the actuaries before the valuation happens.

The motion to approve the meeting schedule carried unanimously.

**OTHER MATTERS TO PROPERLY COME BEFORE THE COMMITTEE**

MR. TRIVETTE asked that information on page 10 of the Buck presentation, where they used the GEM model for the earnings assumption, also be prepared using the Callan model so the committee could compare the two sets of results.

CHAIR ERCHINGER asked Mr. Slishinsky if Buck could do that. MR. SLISHINSKY said he did not know.

**PUBLIC/COMMITTEE MEMBER COMMENTS**

There were no comments.

**ADJOURNMENT**

The meeting adjourned at 12:15 p.m., on a motion made by Ms. Harbo and seconded by Mr. Trivette.

Note: An outside contractor prepared the summary minutes from staff's recording of the meeting. For in-depth discussion and presentation details, please refer to the recording and staff reports and written presentation materials on file at the ARMB office.

Confidential Office Services
Karen Pearce Brown
Juneau, Alaska