State of Alaska
ALASKA RETIREMENT MANAGEMENT BOARD
ACTUARIAL COMMITTEE MEETING

State Office Building
9th Floor South Conference Room
333 Willoughby Avenue
Juneau, Alaska

May 14, 2015

ATTENDANCE

Committee Present: Kristin Erchinger, *chair*
Tom Brice
Commissioner Sheldon Fisher (arrived 10:50 a.m.)
Gayle Harbo
Martin Pihl
Sandi Ryan
Sam Trivette

Committee Absent: None

Department of Revenue Staff Present:
Commissioner Randall Hoffbeck (ARMB Trustee)
Gary Bader (chief investment officer)
Judy Hall (board liaison)

Department of Administration Staff Present:
John Boucher (deputy commissioner)
Kevin Worley (chief financial officer, Retirement & Benefits Division)

Others Present:
Gail Schubert (ARMB Chair) *on line*
Mike Barnhill (Office of Management & Budget, Governor's Office)
David Slishinsky (Buck Consultants, actuary)
Todd Kanaster (Buck Consultants, actuary)
Leslie Thompson (Gabriel Roeder Smith, reviewing actuary)

CALL TO ORDER
CHAIR ERCHINGER called the meeting to order at 9:00 a.m.

ROLL CALL
Six committee members were present to form a quorum.

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

APPROVAL OF AGENDA
CHAIR ERCHINGER stated that people had asked to separately talk about the smoothing of investment gains and losses, as well as the healthcare cost trends for the defined contribution health plan. Those items were not specifically on the agenda but could be taken up under the valuation report discussion (VII, B.3), if desired, because they are assumptions related to valuation. There was a request to discuss the presentation format for the valuation, and she did not expect there would be enough time at this meeting to do that. If time, it could be covered under "Other Matters" near the end of the agenda; otherwise, it would be put off until the August pre-valuation meeting.

CHAIR ERCHINGER said the valuation reports for DCR (defined contribution plan), JRS (Judicial Retirement System), and National Guard and Naval Militia Retirement System were not available last week in time to be in the meeting packet, so that discussion was moved forward to the June agenda. Lastly, there was a request to discuss legislative direction from HB385 and SB119 regarding asset smoothing and level percentage of pay. The original intent was to move those items to the June meeting due to time constraints, but as they are major assumptions in the valuation process they could come up under Item VII, B.3.

CHAIR ERCHINGER commented that it was a tight timeline to accomplish today's agenda, so she apologized in advance if she had to cut anybody off while trying to give everyone an opportunity to speak. She asked the presenters to focus on the higher-level policy issues, the assumptions, and the areas where there are potential disagreements.

MS. RYAN moved to approve the agenda and MR. TRIVETTE seconded.

MR. PIHL said the committee needed to clarify the Alaska Retirement Management Board's (ARMB) responsibility with respect to actuarial assumptions and methods, as there seemed to be some question of who was responsible for what, what could be done without the Board knowing about it – that kind of thing. His view is that the most important item for this committee to address is actuarial assumptions and methods that influence the contribution rate setting, which the ARMB is responsible for.

CHAIR ERCHINGER proposed adding that topic to the June meeting agenda and asking board counsel Stuart Goering to be prepared to discuss it.

MR. PIHL said the problem with delaying the discussion is that the committee has to look at smoothing. There is a draft actuarial report, and he trusted it was not too late to make a change with respect to the smoothing assumption, if that was the will of the Board.

CHAIR ERCHINGER said she understood that the committee has the ability to propose and vote on changes to the assumptions and then recommend that those be forwarded to the full board for approval. If Trustee Pihl wished to have a deeper conversation regarding legal matters, she thought Mr. Goering should be in the room.

MR. PIHL expressed hope for some clarification today with respect to smoothing because it is fundamental to the actuarial reports, and the committee was dealing with a report in draft form right now. It was not too late to have some direction with respect to assumptions in the fiscal year 2017 development of contribution rates.

CHAIR ERCHINGER said she would invite Trustee Pihl to bring those issues up as he saw them individually. She reiterated that she did not see how the committee could get clarification without the board attorney present if it was a legal issue.

CHAIR ERCHINGER stated that Commissioner Fisher wanted to be present for the draft charter discussion, but he was in a meeting with the governor. She proposed moving discussion of the charter until after Item VII, B-2. (There was no objection.)

MR. TRIVETTE remarked that this was a newly formed committee so it was going to take some time to get things pulled together when needed and to make sure everyone was at the table at the right time. Clearly, the committee was not going to resolve all the issues today. There are a lot of complicated issues, and he felt the committee would be doing well if could work out the glitches and improve things in the next year. This board has about ten years of history with actuarial issues, so it was a matter of going through the issues one at a time to resolve them. He added that it was important to have legal counsel present at meetings, and he recommended trying to make sure of that in the future.

In response, CHAIR ERCHINGER explained that Mr. Goering was scheduled to have a family driving vacation during this time. He was willing to pull over and join the meeting by telephone but she thought it best to excuse him.

The CHAIR asked if there was any objection to approving the agenda as amended. There was none, and the agenda was approved.

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

APPROVAL OF MINUTES – April 22, 2015
<u>MS. HARBO moved to approve the minutes of the April 22, 2015 meeting and MR. PIHL seconded</u>. There were no changes, and the minutes were approved.

REPORTS

A. Draft Charter Review/Legal Memo
Deferred until later in the agenda.

B. FY2014 Valuation Reports

1. <u>Reviewing Actuary Report</u>

   a. <u>PERS/TRS current year findings</u>

   LESLIE THOMPSON of Gabriel Roeder Smith & Company (GRS) referred to the written review of the PERS and TRS pension actuarial valuation and other post employment pension benefits (OPEB) valuation, dated May 4, 2015 *(on file at the ARMB office).* She specifically drew attention to the key findings starting on page 2. GRS has an issue on how normal cost is being calculated, and they have started the discussion with Buck Consultants. It has to do with the salary that is being used in developing the normal cost rate. The discussion is ongoing and without resolution at this point. She expected this would be an open issue that would probably need to be presented in June.

   MS. THOMPSON said regarding the pay issue that was brought up at the April 22 committee meeting that GRS had some participants when they looked at test lives that the pay being used was different than the pay that came over on the payroll data. For an actuary, this is completely proper and expected. GRS asked Buck about these people, and Buck showed how they had applied the salary scale to move the pay forward one year. GRS was satisfied with what Buck was doing in terms of developing the benefit payroll. She thought there might be an outstanding issue on the payroll used for the rates (rate payroll), but she did not have comments on that pending Buck's presentation on that issue.

   With regard to the roll-forward calculation, MS. THOMPSON said there is still an outstanding issue of whether it is market value or smoothing – the same issue that others have raised.

   GRS had some concerns about some numbers that were not matching, and Buck agreed. The mismatch occurred between Buck's numbers in the projections versus numbers that were in the projected roll-forward, and Buck will synchronize those up with the final valuation report.

   MS. THOMPSON mentioned that part of her review was teeing up issues that GRS needs to hear from Buck on, and some of these issues remain as continuing concerns. She pointed out that under termination there have been losses every year on both PERS and TRS. When an actuary sets an assumption they try their best to set it at its expected value, which means sometimes the actual value is greater and sometimes it is less. But when there is a pattern of losses observed every year the question arises that something is wrong. She said this is probably the third or fourth year that GRS has talked about its concern on the termination assumption. This still does not reflect the new assumptions that the ARMB just adopted. The gain/loss on those new assumptions will occur in the valuation. GRS will be looking to see if that pattern has changed with the next assumptions.

   MS. THOMPSON spoke about the rehire loss that occurs all the time, which is typical that rehires are a loss. This might be the indebtedness issue that Mr. Slishinsky spoke of at the April meeting, where people are coming back into the systems. GRS is recommending that Buck set an explicit assumption for rehires so there is not a bias in that particular assumption that is occurring in the valuation and so it can be paid for upfront.

CHAIR ERCHINGER said the question had come up about if the legislature had changed the ability for people to come back into the system if they had not done so by July 1, 2010. She asked if someone could briefly clarify that liability.

MS. SLISHINSKY of Buck Consultants explained that those are people who were not active in the last valuation who are now active, who have prior service. There can be many different reasons why somebody would come back into the retirement system or why they would have past service. Buck does not get into the reasons; they just know that it is happening.

There was a brief exchange about people who had taken out their retirement money when they terminated and had until July 1, 2010 to be rehired and reinstated in the retirement system. There are also people who did not take all their money out, and those people either have come back into the system or could come back. Those people might have only two or three years to retire, and it creates a big liability for healthcare benefits.

MS. THOMPSON next addressed the substantial gains in healthcare every year, which she had brought up at the April meeting. Because of the healthcare valuation process, there are gains each year in PERS and TRS. She recalled that a year ago the Board's discussion was that the margin was intentional. This year Buck has proposed changes to the healthcare trends that will affect those numbers. She said she was not clear how explicit the Board has set this desire for margin in the retiree medical portion of the plans, and that is the basis of the discussion on the healthcare valuation process.

CHAIR ERCHINGER asked what GRS's experience was with the process of how other states deal with their review actuary recommendations.

MS. THOMPSON replied that the board first has to understand where the margin is (the rates being charged are higher than they need to be). The board then would meet with the actuary and review what the alternatives are to get the desired outcome.

She added that one of her more policy recommendations is that the Board needs to hear a lot more from Buck on what is going on with medical. She is concerned that there are so many gains on healthcare, but there could be something else going on, such as a trend reversal approaching. Health markets are different than pension markets because they go through marketing cycles. For example, Kaiser in Colorado will for three years have certain expenses and then they might say they are going to get this market; then they lower their premium because they have other interests that are going into that premium calculation. The ARMB would not want to build a whole future on a marketing cycle. As another example, Aetna could decide to stop paying certain claims, which could result in gains on the healthcare assumption. This is the kind of wisdom that the Board needs to get from Buck, and she did not see that type of information in the valuation report.

MS. HARBO commented that almost two-thirds of the retirees are under Medicare, and the healthcare costs for those people drop significantly for the state. She guessed that by 2050 every retiree in the defined benefit plan will have Medicare coverage because it is a closed system.

MS. THOMPSON drew attention to pages 5-6, the checklist of what GRS thinks are outstanding issues.

On page 22, she said GRS gets excellent test lives from Buck, the best she has seen in the industry. Because the matching is so good, it tells her that the assumptions they claim are being applied to the data are really being employed. GRS checks that on an individual basis, person by person. Page 22 is a match on the total present value of benefits for each person. Present value of benefits is ultimately split between normal cost and accrued liability, and GRS's finding is in the split and how the normal cost is calculated. But on the present value of benefits basis the committee can feel very confident that all liabilities are being valued.

Going back to page 15, MS. THOMPSON stated that GRS recommends that the participation assumption be studied. The assumption right now is 100% participation if things are paid for and 10% if they have to pay for themselves. There is enough time to study that assumption.

MR. TRIVETTE said he thought the participation assumptions were way off, just from anecdotal feedback that he knows of regarding retirees who are not taking the state retiree health insurance right now. He asked if there were reasonable ways to get actual information.

MS. THOMPSON said she would defer to staff and Buck on that because the answer lies in what kind of data could be gotten.

MS. SLISHINSKY interjected that he would show some numbers later on that might help with that.

MS. THOMPSON next addressed the Cadillac Tax. GRS advises all their clients that the Cadillac Tax is not an issue of if; it is an issue of when. GRS is finding more and more that it is the auditors that are requiring an explicit assumption for the Cadillac Tax. That is why GRS has included it, and she thought Buck had a response to that in their presentation. She believes the ARMB needs to start preparing for the fact that a Cadillac Tax will have to be paid at some point and how that will be done. That will lead to whoever is handling the healthcare plans to start looking at whether to do something with benefits rather than pay taxes. There are opportunity issues to weigh there.

MR. BADER asked if the Cadillac Tax was on the beneficiary or on the plan sponsor. MS. THOMPSON said it was the plan sponsor, but the caveat is that people say they will pass it on.

CHAIR ERCHINGER requested an explanation of the newly identified issue that is considered to have a non-trivial impact (page 5).

MS. THOMPSON replied that when Buck calculates normal cost they have a normal cost dollar amount (the numerator), which has retirement, termination, and death (all the benefits that could happen that the normal cost has to be paid for). But in the denominator, when Buck divides it by salary, they have salary with no decrements (they assume the salary will be for the whole year the first year). GRS is saying that that salary needs to be decremented, just like the numerator, and that shrinks the salary number, resulting in a higher normal cost rate. That is the debate being resolved right now.

b. <u>Claim cost supplemental study</u>
MS. THOMPSON explained that this report looks at healthcare cost claims and is more of an issues report because it goes through all the retirement plans that have healthcare. She reviewed the May 14 cover letter that outlined the high-level topics:

- Lack of provider claim data to GRS that confirms total claims. GRS was trying to find the reports from each carrier that added to the total claims number that Buck is looking at, so they could see that all the claims were being measured and factored in. GRS did not see that report.
- Lack of external data for confirmation. These are the higher-level consolidated management reports. It is not that these reports do not exist, but GRS did not get them when requested.
- Margin is built into the claim costs. This was talked about earlier and is a policy discussion that the ARMB should have with Buck.
- GRS would like the Board to get a lot more of Buck's wisdom around healthcare and trend and why Buck is changing an assumption. Perhaps the Board will want an experience study on the healthcare side.
- Credibility. This means what is the most believable set of data in a healthcare valuation. GRS's opinion is that the more recent the data, the more credible. Buck has a different approach: not meaning that it is wrong, but GRS wants to hear Buck's wisdom for not assuming the most recent year of the data is the most credible.

KEVIN WORLEY responded to a question from MR. PIHL about the possibility of Medicare-eligible retirees opting to bypass Medicare and use state healthcare benefits instead. He said that when a retiree reaches 65 years of age Division of Retirement & Benefits assumes that the person has applied for Medicare and automatically takes the position of paying secondary.

MIKE BARNHILL stated that retirees that are not covered by Medicare submit a certification of non-coverage from CMS, and then the state plan pays primary. This is a small but growing population of close to 1,000 retirees that is estimated could reach as high as 4,000.

Continuing with her report, MS. THOMPSON said she is noticing on the trends that the medical pre-65 now is higher, except at some of the very later ages. She found this surprising because there is margin, so this needed clarification. The post-65 medical rates are coming down, as Trustee Harbo mentioned. She said Buck is using the Getzen model of long-run medical cost trends for the State of Alaska, which is sanctioned by the Society of Actuaries. In that model, Getzen states that the ultimate trend has to converge to GDP. Her interpretation of Buck's analysis is that last year they thought the GDP would be 4.5%; now it is going down to 4.0%. She did not have a problem with that because she thought long-term GDP was actually going to be less than 4.0%, and the models will see that coming down over time.

MS. THOMPSON stated that the trend rate for retired member medical contributions (certain retired members have to pay) has changed. The question she has posed to Buck is if there actually should be a difference between Medicare and non-Medicare contribution rates, or is it the policy that those are blended for retired members. Right now, there is only one rate for all retirees. How to determine what to charge retirees would be another area to explore while the Board is exploring margin.

MS. THOMPSON pointed out that an assumption is used that we get more expensive as we age in a medical sense, and that is not disclosed in the valuation. She advised adding that in the valuation.

GRS recommended that the ARMB study the participation and election rates in the healthcare plans. People are making different decisions: Obamacare, who they marry, etc., so maybe it is worth studying.

Regarding TPA (third party administrator) fees, MS. THOMPSON pointed out that the trend assumption is 5% per year. But the increase from 2013 to 2014 was from $177.57 per person to $198.98, so it would be good to find out why. There is a new fee called Healthcare Legislation Expense that got added into the valuation on the healthcare expense side, and the Board needs to find out what that is. Her general concern is in changing a fee without the ARMB knowing about it in advance, but also some expenses cannot be paid from a pension trust fund. So before anything is paid out, the Board has to be sure its legal counsel approves it. That may have been done and GRS is just unaware of it.

2. <u>Discussion: Summary of GRS Findings</u>
   <u>Comments/Recommendations</u>
   CHAIR ERCHINGER remarked that it was becoming increasingly frustrating for her to not know what has changed from last year to this year, specifically on the assumptions. She asked Buck, in the future, to prepare a simple spreadsheet that shows the assumption last year, the recommended assumption for the coming year, and the Board's ultimate decision on whether to implement a change. The reports clearly say that the ARMB has approved the assumptions in the valuation, but issues come up in discussion that the Board has not even heard about. By default, the Board is said to have approved the assumptions.

MR. SLISHINSKY said the intent is to have a summary of the change in assumptions outlined in the valuation report after the assumption section. He referred to a table on page 103 in the PERS valuation report that showed what the 2013 assumptions were and 2014 assumptions.

MR. PIHL commented that that has to happen before the draft valuation is prepared. MR. SLISHINSKY replied that this information was in the experience analysis report, and Buck also put it in the actuarial valuation report to document what the changes were in the assumptions for this valuation. He confirmed for MR. PIHL that when the Board approved the experience analysis it was approving the changes. He added that Buck's understanding was that the experience analysis was approved for the 2014 valuations, but part of the purpose of the Actuarial Committee is to go through these assumptions to see if there are going to be any changes for the 2015 valuations.

CHAIR ERCHINGER thanked Mr. Slishinsky for pointing out the table on page 103 in the PERS report. She said it was helpful, but she was not certain that the issues Ms. Thompson brought up were presented in the table as assumption changes. She asked that Buck include all the assumption changes in the interest of transparency and so there are no misunderstandings going forward.

MR. BOUCHER said he understood that the new Healthcare Legislation Fees that Buck listed in the valuation were associated with Affordable Healthcare Act fees that are levied on the plan.

At the CHAIR's request, MR. BOUCHER agreed to provide the committee with a written explanation.

MR. TRIVETTE remarked that if the new fees were a result of federal law, he wanted it vetted by board legal counsel as well.

3. Reviewing PERS and TRS
Valuation reports, including payroll reconciliation and payroll growth assumption; indebtedness assumption, amortization of unfunded accrued liability
(See Buck Consultants' presentation slides dated May 14, 2015, on file at the ARMB office)
MR. SLISHINSKY said the folder to the notebook contained information that was discussed and requested at the April meeting that he wished to address first.

MR. SLISHINSKY drew attention to a chart on page 4 showing Medicare participation for over age 65 retired members, broken out by Tier. He said he spoke with the healthcare actuary about the data, who explained the data from Buck's viewpoint. The TPA does not know if somebody who is 65 and has a medical claim is Medicare eligible or not. Buck's understanding is that the TPA will send a claim to Medicare, and if Medicare rejects it then they know that the person is not participating in Medicare.

MS. HARBO said she thought a retiree turning 65 was supposed to notify the Division of Retirement & Benefits if they were on Medicare or not, and the TPA would be secondary coverage for those eligible for Medicare.

MR. SLISHINSKY responded that the question is how that information is collected and stored and if it is passed on to Buck. He added that the data on the Medicare participation chart came from the TPA's claims report, and perhaps DRB has some data on Medicare eligibility. In Buck's early days working for the State, they took the high road and assumed that people hired prior to 1986 were not participating in Medicare because Buck had no information that people were Medicare eligible. As Buck started getting better information from the TPAs, they kept updating what they had: the information is the best it has ever been but it is still not perfect.

MS. HARBO said she figured out that almost two-thirds of the TRS retirees now are eligible for Medicare. That should be a significant drop in healthcare costs for the retirement system.

MR. SLISHINSKY said that Buck is using this information and valuing the lower secondary claim cost piece of healthcare benefits for these people. What surprised him was the extent to which there is significant coverage in Medicare for retirees age 65 and over. That may be because the PERS/TRS retirement eligibility age is quite low, and there could be people who are retiring pre-65 and then getting jobs in the private sector and earning their 40 quarters of Social Security coverage before they even reach 65. He calculated that 94.5% of pension retirees over 65 were in the retiree health plan, which is quite high. Buck's assumption is that everybody is going to elect coverage in the healthcare benefit, so they do not have any discount for people who do not participate. That adds to a margin in the valuation when Buck assumes 100% participation in the retiree health plan when 95% are actually participating.

MR. TRIVETTE said it was good to point out that that is part of the healthcare margin. He added that many of the 5% who are not participating in the state retiree health plan are likely working in other jobs and using an employer benefit as primary coverage.

MR. SLISHINSKY next reviewed a chart of all PERS and TRS retirees regardless of age, noting that there are more people that are not deemed to participate in Medicare. His sense is that Buck is putting those people in that group because they do not know (the people are not Medicare eligible yet for claims, so Buck does not know if they have their 40 quarters or not).

MR. SLISHINSKY stated that most healthcare plans are not funded by the retirement system. Alaska's funding of healthcare plans is probably the best in the country. Various things are happening all over the country with the funding of healthcare benefits, particularly in light of GASB 43 and 45, which for the first time actually measured the liabilities and showed states and plan sponsors how high they were and what they have been doing to tackle the issue. Plans have started on that path, but they have been so far behind that they are nowhere close to where Alaska is.

Buck developed the data from the claims in the financials to show the average annual pension and healthcare payments per retiree for PERS and TRS combined for 2005 to 2014. There is a slow steady increase in annual payments on the pension side (average 1.44% over this time period), but the rate of increase on the healthcare side is a little choppier (average 1.54% annually). The beginning healthcare trend rate is 8%-10% that grades down over time to something between 4% and 5% long-term. He guessed the average was 6%-7%. He believed that is where the gains on claims are coming from. Healthcare actuaries do not expect this kind of trend to happen long term; they still hold to their guns on the increase in the cost of healthcare and will not allow a healthcare cost trend rate of 1.5% to 3.0% in the valuations.

MR. SLISHINSKY agreed with MR. PIHL that the ARMB wants to have margin in the healthcare trend assumption. Actuarial standards of practice allow for some margin to make sure that the plan is meeting the benefit obligation long term, which is one of the Board's primary goals as fiduciaries.

CHAIR ERCHINGER said this was a great conversation, and the possibility of considering a healthcare consultant to do a deeper analysis on some of these issues was mentioned earlier. It sounds like the data itself may be incomplete, either because DRB is not able to get that data or just because Buck is not getting that data. Then, because the data is incomplete, the ARMB is not getting good explanations of what is happening.

As an alternate course of action, MR. SLISHINSKY proposed having a representative from the TPA make a presentation to the committee to explain what they do and what is happening.

[COMMISSIONER HOFFBECK made a brief appearance to explain that both commissioners had been called off to other business.]

Regarding the pre-65 and post-65 retiree medical issue, MR. BOUCHER stated that most of the data from Aetna is on the retiree group as a whole. The Administration has identified this as an area of need for a lot more information. As Trustees have indicated, there is a potential that healthcare costs are being driven down by the demographics and who is paying primary. There have been at least three TPAs over the eight years that Buck has been the State's actuary, so data inconsistency is an issue. Healthsmart, in particular, was not a very sophisticated data collector. Aetna has provided the State a data warehouse of claims data that the State believes can really be leveraged to do a deeper dive into this. However, that will only mean being able to go back into Aetna's information. The State has tried in that forum to marry Aetna claims data with Healthsmart claims data, but that has been an extreme challenge with millions of claims and broad categorizations.

MR. PIHL expressed that the committee was spending too much time on data matters, which he thought were fully the responsibility of the Department of Administration. He knew they were doing their best job to get the information to deal with the problems, and he felt the committee needed to get on with the actuarial valuation assumptions and methods. If there were problems with the data, the committee would hear about it from the actuary and reviewing actuary.

CHAIR ERCHINGER said one comment from the reviewing actuary was insufficiency of data on which to make these healthcare estimates, and they are big cost drivers. She thought the committee would need to do a deeper dive on the data in the future, however, she agreed with Mr. Pihl about moving along for the sake of getting to the agenda items that committee members want to weigh in on.

MR. SLISHINSKY continued review of the healthcare cost trend rates and explained the reasons for Buck's proposed change (page 8). For the 2012 valuation, Buck had recommended that the ARMB adopt the Getzen model. Buck has been using the Getzen model to estimate the reportable liabilities for retiree healthcare benefits for accounting purposes. The model was updated in 2014 by a project oversight committee that compared the projections in the model with more recent experience. Buck is recommending in this valuation to adopt the changes made to the Getzen model by the oversight committee. It decreases long-term ultimate trend rates, but these ultimate trend rates start at about fiscal year 2020. Buck has blended in the proposal for changing the short-term rates that include actual increases in the pre-65 medical cost trend rates and a reduction in the post-65 and prescription drug trend rates. Buck believes this addresses the potential savings impact of switching to a new claims administrator. On the plus side, competition in the marketplace drives the initial cost that the State negotiates downward; then there is a tendency for costs to spike up in the second and third year under those contracts. Networks and care management practices are improving, which is adding to a reduction in claims.

Addressing the most recent significant actuarial gains on claims, MR. SLISHINSKY said even with the reduction in the long-term trends there is still significant margin compared to most recent experience. Buck does not necessarily expect that experience to continue. The trend rates apply to all ages of actives, the deferred vested, and retirees, and they affect the average claim amounts that Buck is using in the valuation as of June 30, 2014 and applying those rates going forward for the entire future lifetime of the membership. Just a half-percent change in these rates can affect the projected liability greatly.

MR. TRIVETTE said it would be good to be able to show the public, through listing out where all the margins are, that the ARMB is being super conservative on the healthcare trend rate assumption. He recalled that the GRS report had suggested that. He asked Mr. Slishinsky if the increase in healthcare cost trend rates for medical pre-65 starting in FY15 was really justified, given the sizeable margin already in the assumption.

MR. SLISHINSKY responded that the answer is "yes," in the professional opinion of Buck's healthcare actuaries, because they are seeing the higher increase in costs in the pre-65 population.

CHAIR ERCHINGER remarked that it seemed the committee did not have enough information to answer that question. Specifically, did the committee really know that the current healthcare margin was "super conservative," as Mr. Trivette just described it?

Perhaps relative to the last few years' experience, but the committee does not know what is driving that underlying change.

MR. TRIVETTE agreed, adding that the committee may never get all the answers to what is driving the margin. That is why he thought it was so important to do the experience study because it tells what really happened, at least for a four-year period.

MR. SLISHINSKY said that is an area for judgment, and judgment is a bridge between the data that tells you what you know and the perception or belief in what you don't know. In order to finalize these kinds of calculations, the actuary uses judgment all the time because the data only tells 90% of the story.

CHAIR ERCHINGER asked that during the break committee members gather their critical list of items to cover in Mr. Slishinsky's presentation, and she would provide an opportunity before the next presentation to get to those.

MR. SLISHINSKY next addressed the methodology to eliminate the two-year lag in contribution rates, pointing out that page 11 explaining the implementation procedure was the same as he had presented before. The new roll-forward procedure for PERS on page 12 was also the same (a roll-forward of the accrued liability and the assets). The asset roll-forward assumes an 8.0% return for FY15 and FY16. If the retirement fund earns the 8.0% return each year, it is interesting to note what the funded ratios would be in that case: pension would be a little less than 68%, and healthcare would be almost 89%. All those large gains on claims over the past five years, as well as making the adjustment in the healthcare cost trend rates, is working to reduce the liability on the healthcare plan. If the gain is $300 million over the next six years, the healthcare is likely to get to 100% funded (in six years as opposed to 23 years). Once at 100% funded, healthcare would not need any margin. The ARMB needs a policy on the reason for the margin.

MR. SLISHINSKY drew attention to the calculation of the FY17 contribution rates for PERS (page 13).

CHAIR ERCHINGER pointed out that the asterisk that the PERS calculation included Buck's proposed reduction in healthcare cost trend rates is a great example of something rolled into the valuation that the Board has not discussed or weighed in on. MR. SLISHINSKY acknowledged that it was a proposed change. CHAIR ERCHINGER continued, asking how it would affect Buck's work going forward to set contribution rates that if the Board were to say it did not want to change the healthcare assumption. MR. SLISHINSKY said the accrued liability for healthcare that Buck started with would be higher on page 12 (the $7.9 billion would go up $439 million). That would drive the projected funded ratio down and increase the contribution rates to amortize a higher unfunded liability, trickling down to all the calculations.

MR. BRICE remarked that he did not live in a world where healthcare cost assumptions constantly go down, so for Alaska he was wary about the use of the Getzen model that had the healthcare assumption trending downward.

CHAIR ERCHINGER noted that in 2014 the model assumptions were updated, but it was still the issue of whether to trust the data. For that reason, she was not necessarily supportive, but she did not have enough information to say whether it was prudent to reduce the healthcare liability by $439 million. It troubled her to just assume that.

MS. HARBO said that in 2000 the State of Alaska was one of only four states that provided healthcare to its retirees. She asked if that was still true. MR. SLISHINSKY said he did not know what the number was now, but it was a relatively small group that provided full coverage. Many states provide a subsidy.

The committee took a break from 10:40 to 10:50 a.m.

CHAIR ERCHINGER noted that Commissioner Fisher had joined the meeting for the remainder of the morning session but not the afternoon. Without objection, the committee would take up the Draft Charter Review/Legal Memo next (item VII.A. on the agenda).

A. Draft Charter Review/Legal Memo

CHAIR ERCHINGER drew attention to the proposed Actuarial Committee Charter change that was reviewed with Board legal counsel Stuart Goering before he left on vacation. Mr. Goering also submitted a letter explaining the legal reasoning for the recommendations he made to the proposed changes to the charter. These primarily had to do with the need to make sure that the charter was not allocating more responsibility and power to the committee that more properly should be residing with the Board as a whole. The charter language was changed to state that the actuarial committee is making recommendations to the Board and not the committee itself that is acting.

Mr. Goering made a recommendation in the letter that the CHAIR did not include in the charter. His recommendation was, rather than articulate under Section II the specific Board responsibilities from the state statute, that the committee might want to just reference that citation of the statute. She felt, as a member of several ARMB committees, that it is always helpful to have the charter specify what those responsibilities are, rather than having to go back to the statute. In this case, she copied verbatim the wording from the statute into the charter. Mr. Goering also rightly pointed out that when she previously used the state statute and attempted to paraphrase it that it could be argued that some of the language was changing the intent of the statute. His recommendation was that it is always safer to use the actual verbiage from the statute, rather than try to change it in any way.

CHAIR ERCHINGER explained that the above changes resulted in the redlined version of the committee charter contained in the meeting packet. Subsequently, she asked the other committee members for additional information, questions or comments. Committee members then received a letter dated May 13, 2015 from Commissioner Fisher, along with some additional proposed changes to the charter.

CHAIR ERCHINGER stated that she had committed to Mr. Goering that so long as there was no objection to the redlined version of the charter in the packet, and the committee decided to vote on that version, then the committee would proceed to do that without him in attendance. But if there was anything of substance that could potentially be seen as controversial or requiring additional legal analysis or answers to questions then she would ask the committee to not actually pass the charter but to discuss it and hold the substantive conversations when Mr. Goering returned by the June committee meeting.

CHAIR ERCHINGER asked Commissioner Fisher to present his comments, after which the other committee members could comment or ask questions.

COMMISSIONER FISHER stated the Department of Administration was quite supportive of the concept of an ARMB actuarial committee and really had only one issue to highlight as a distinction between the draft that was prepared and the letter's comments. It goes to "what is the staff work" versus "board work." Part of the reason it took so long to get the letter to committee members was in getting the Department of Law's view and opinion on that. As the department understands the statute and the way that line has been drawn is that there is a distinction in terms of the relationship that the Department of Administration (DOA) has with the actuaries versus the Board. The distinction is that there is a direct relationship between state's primary actuary (in this case, Buck Consultants) and DOA. DOA is the one that contracts with and manages that. The ARMB contracts with and manages the review actuary, and an audit actuary when that is necessary. That is not to say that the department cannot and should not cooperate, and the department wants to. Part of what has happened in the past is there has been a feeling that perhaps that cooperation has not been as fulsome as people would like. People may want to talk about that. In listening to both members of the Board and this committee, and in talking to others, he believes there is a real difference about what is appropriate in expectations, etc. He committed that he is open and will continue to support cooperation.

Turning to the draft charter, COMMISSIONER FISHER said that some things specifically related to unilateral control and access and communication with the state's actuary, and meeting with the state's actuary in the absence of management, those sorts of things, it was the department's sense that that kind of went too far. So they tried to distinguish between the role of the ARMB and this committee as it relates to the state's actuary versus as it relates to the review actuary and the audit actuary. This issue is the genesis of the letter's comments, which flows through in a number of different places.

COMMISSIONER FISHER said he had conversations with Mr. Goering and more generally with the Department of Law regarding the department's general position that the ARMB is not entitled to hire independent legal counsel absent the approval of the attorney general. By statute, the attorney general is the legal officer, and the attorney general may consent to hiring independent counsel, but the ARMB does not have that discretion. So the department also took the language out of the charter that talked about hiring special legal counsel.

MR. PIHL commented that the charter was going to be a charter of the ARMB, so he would substitute the word "primary" for wherever it says "state's actuary." The statute says that the hiring of the primary actuary is supposed to be a coordinated effort of the ARMB and the Department of Administration. The Board fully understands the department signing the contract, and the department has most of the relationship with the actuary. The Board has the responsibility of approving actuarial methods and assumptions, and that necessitates the power of the ARMB to have some involvement with the actuary. In the last several years under the prior administration and Mr. Barnhill, there has been tremendous improvement in the cooperation effort between the ARMB and the Department of Administration. He viewed the strenuous wording in the letter as a step way back. He hoped to continue the atmosphere of cooperation.

MR. PIHL stated that, aside from that, he had a couple of recommendations for the charter. One of the functions as a committee is to assist the Board in determining and directing actuarial methods and assumptions, and that should be clearly stated in the charter. He recommended that it be the first sentence on the first page of the charter, under Actuarial Committee Purpose. Another minor change would be that DRB has been providing the Board with actuarial bills, and it would be natural that the Board look to this committee to review those invoices and, thus, take less time at a board meeting.

CHAIR ERCHINGER said she was keeping notes on all the recommendations to be discussed and voted upon. She expected to incorporate all the approved changes into a new draft document that could be taken up at the June meeting.

COMMISSIONER FISHER mentioned that he would not be at the June meeting. He wondered if the committee could come to some agreement in the meantime, even if it was not formally voted upon.

MR. PIHL clarified that he thought his recommended change to put “assist the Board in determining and directing actuarial methods and assumptions” in the charter should be in two places, the second being at the beginning of Section II.A.1., Actuarial Committee Responsibilities and Duties, on the first page.

COMMISSIONER FISHER said he agreed with the Chair inserting the verbatim language of the statute in that section because there is power to that and it serves everyone well.

MR. PIHL said his suggestion was not to modify the language of Section II.A.1 that references statutory language, but to renumber it to be the second point and insert as the first bullet the blurb about assisting the Board in determining and directing actuarial methods and assumptions.

MS. HARBO stated that she had no problem with the changes that legal counsel Stuart Goering recommended to the charter, after he had had time to review it thoroughly following the committee’s April meeting. However, she was having trouble with the changes the commissioner brought forth in his letter. For example, changing “actuary” wherever it occurred in the charter to “State actuary” was unnecessary. She had been ready to vote for the version that incorporated legal counsel’s recommendations.

CHAIR ERCHINGER clarified that the committee actually voted to adopt the original version of the committee charter at the April meeting. The version in this meeting packet incorporated legal counsel’s recommendations once he had reviewed what the committee had adopted in April.

MR. TRIVETTE mentioned that the ARMB has experienced difficulty in getting access to information from the actuary in the more distant past. He did not agree with the notion that this Board was trying to have total control and access to the actuary, and he did not think that was ever intended. Further, he and the more senior trustees are very much aware that the Board does not have any authority to contract with outside legal counsel and must go through the Department of Law. They learned that in the training session during the first week of being on the ARMB. He said the Board was striving to have better communication with the actuary, and he was the person who pushed to look at the billings from the actuary to see what was going on. In 2005, there were issues where some actuarial work was being charged to the PERS and TRS funds that should not have been charged to the retirement funds, and the legislature fixed that. This is a new committee that is just starting to address some long-term issues, and it will take a year or two to get everything in place. Much of it is making sure that the committee and the Board have all the information coming in from the various sources that they need. The Board is getting a lot better at this than ever before, and he was hopeful about getting where they needed to be.

CHAIR ERCHINGER stated that in her years on the board past practice has not limited the definition of the primary actuary to the State's actuary, in terms of what she thought she read in the letter which was the Department of Administration's actuary. She found that very concerning. That change in definition is a fundamental change that is actually dangerous to the integrity of what the ARMB and committee are trying to accomplish, as well as to the bridge that people are trying to build together, in support of one another, in engaging the services of an actuary that carries out the recommendations for the actuarial methods and recommendations of this board, but also doing so in a way that the Department of Administration is responsible for putting them into place. From what she has seen, the ARMB has never tried to step over that line of telling the Department of Administration how to do their work. Instead, the ARMB has tried to be the policy setting body looking at the actuarial assumptions and methods, and that needs to be retained. She wanted clarification if she had misread the intention of the letter that the primary actuary is not the actuary of the ARMB. First, the "State's actuary" is not defined in statute, that she could find. It is certainly not limited to the Department of Administration. If there was going to be an effort to define it, then she thought it should be by regulation that the primary actuary was something other than how past practice has interpreted that.

CHAIR ERCHINGER said there is another provision in statute that talks about the State's performance consultant. It is the same verbiage and same capitalization of "State," and, to her knowledge, the State of Alaska outside of the ARMB does not have a performance consultant. So if the reference is going to be to the State's performance consultant and say that the State does not also mean the ARMB, she thought that was thin ice. The ARMB is a branch of the State of Alaska, so the State's actuary, in her opinion, has always referred to the actuary that is shared and co-engaged, and where there is supposed to be cooperation on hiring.

COMMISSIONER FISHER asked if the Chair saw a distinction between the responsibility of the ARMB and the Department of Administration vis-a-vis the primary actuary versus the review actuary.

CHAIR ERCHINGER said her reading of the statute shows a distinction as it relates to the hiring of the actuaries. The statute is clear that the ARMB will coordinate with the DOA commissioner on the hiring of the primary actuary. The statute says specifically that the ARMB will hire the review actuary. Her understanding of intent and historical practice on this Board is there has never been a distinction that, because there is a difference in how the primary and review actuaries are hired, it means that the primary actuary is not as much the Board's actuary as it is the Department of Administration's actuary.

COMMISSIONER FISHER said it seemed logical to him that if the legislature allocated to one party the hiring of one actuary and to another party the hiring of the other actuary that they contemplated kind of a check-and-balance in those relationships. He also agreed there has to be cooperation. Where the department management feels the charter goes beyond the scope of the statute and starts to infringe on the staff work is when it says this committee is the one that will take the lead on the pre-valuation entrance conference with the primary actuary, or that the committee will have a kind of unilateral right to meet with the primary actuary in the absence of management. Those points feel like moving beyond the balance that was struck in the statute, to begin to shift the relationship away from the department towards this committee, which he did not feel was intended in the statute or was even a healthy ambition for this committee to take on.

CHAIR ERCHINGER expressed some disagreement with those comments, first, that the ARMB was attempting to do anything unilateral. Regarding the pre-valuation conference, the charter states, *"Schedule an annual pre-valuation entrance conference with the Actuary that includes DOA and DOR staff and the Review Actuary to discuss scope, staffing, locations, timelines, reliance upon management, and general approach to the annual valuation conducted for the retirement systems; and in the year that an actuarial experience analysis is conducted, schedule a similar entrance conference."* This is consistent with how the ARMB Audit Committee has worked when it schedules a pre-audit conference with the auditors, and the auditors explain their audit approach, timeline, and when to expect deliverables. To her, the pre-valuation conference is an important coordination effort: the conference would include the DOA and DOR staff, the actuary, and the review actuary, and there is nothing in there unilateral or secretive. There is reference in the charter to holding a meeting with the actuaries at some point, in the absence of management. That is also something that is consistent with how the Audit Committee operates with the independent auditor. That meeting with the actuary is an effort to make sure that the direction that the Board has given has been carried out, and to provide the opportunity to ask those questions, as a committee would do in any good due diligence process. There is no intent to be unilateral in any kind of actions that the Board is attempting to take. She invited the commissioner to propose different language for the section on the pre-valuation conference that would help clarify the intent.

CHAIR ERCHINGER mentioned the commissioner's reference to the statute that one party is responsible for hiring one of the actuaries and the other party is responsible for hiring the other actuary. She did not see the statute in that way: the one section of the statute that talks about the review actuary specifically says the ARMB will hire the review actuary. The section that relates to the primary actuary very specifically states that the ARMB will coordinate with the commissioner of the Department of Administration to hire that actuary. There is nothing unilateral that gives that responsibility to DOA or the ARMB, and nothing that excludes the ARMB from participating in both hirings.

CHAIR ERCHINGER said she thought it was going to have to come down to a legal discussion about the intent of the statute. Perhaps the committee would have to ask for research on legislative intent. Her concern about going down that road, and at the end of the road deciding that DOA has a primary actuary, is that then this board needs a primary actuary because the ARMB is the body that is supposed to be responsible for setting assumptions. She would not like to be hiring two primary actuaries, one for the administration and one for the ARMB. It would be unnecessary cost, and it would not be partnering and working together. She did not think it was the intent of the statute, and she hoped the situation did not end up there.

COMMISSIONER FISHER said he did not disagree with the last statement. He agreed that it came down to a legal interpretation of the scope. He noted that Mr. Goering's comments did not go to the issues being discussed now, and there was no legal representation at this meeting. He stated that the Department of Law reviewed the information he presented and basically said that it was consistent with the statute, but someone from DOL probably needed to be in the room to speak on it.

MR. TRIVETTE related that as recently as September 2014 the ARMB found out that GRS had not actually received Buck's actuarial report, and GRS was asked to give their review of it. After almost ten years into the statute that created the ARMB, one would think providing the actuarial report to the reviewing actuary would be pretty basic. That glitch is history now, but it is partially the reason why this committee is here, to make sure that all the moving parts come together and function smoothly. A couple of years ago, when it came time for GRS to look at DCR's healthcare plan, they reported that they could not do so because there is no plan yet. It is how the Board found out there was no DCR healthcare plan.

COMMISSIONER FISHER stated that he strongly agreed with the objective, and even in his short time on the board he could understand some of the issues and desired to provide that oversight. He added that while the ARMB has the legal right to hire its own primary actuary, nobody thinks that is the solution. However, the department perceives that the draft Actuarial Committee charter, prior to DOA's edits, changes it from the Board having the right to hire its own actuary to the Board has the right to treat the State's primary actuary as if it's the ARMB's own actuary.

CHAIR ERCHINGER said that was the case.

COMMISSIONER FISHER said the department will work with the ARMB to try to facilitate that, but if there comes a point where that does not work, management understands that the solution is for the Board to hire its own actuary. He agreed with the Chair that it would be a crisis and be foolish, and it would mean that the relationship would have broken down, but it is what is contemplated in statute as the solution. DOA is just trying to preserve what management sees is the statutory lines, but it does not reflect how they intend to work. They want to continue the process that he was pleased to hear people say has improved over the last few years. If the process needs to improve further, then he was all for figuring out how to do that. He mentioned that trustees, in conversation with him, have expressed certain frustrations, and then he talked to DOA staff about their view of those. He thought there were times where the department will see issues differently. It is important to draw the lines where, in management's judgment, the statutory lines are drawn, and then to work together to bridge that as much as possible.

MR. PIHL said it was as simple as writing a charter that reflects how the parties intend to work together. Specifically, he could understand DOA's reaction to the words "in the absence of management" in bullet point B-5 regarding the committee meeting alone with the actuaries. That task was taken from the Audit Committee charter, which requires that that committee meet with the auditor in the absence of management. He did not have a problem with deleting the words "in the absence of management," if that offended the department.

CHAIR ERCHINGER mentioned that the ARMB has stated that where committee members or board trustees wish to have direct communication with the actuaries it is only on the approval of the board chair. Then, the results of those requests go from the actuaries to the requesting trustee, but, in addition to that, go to both the Department of Administration and the Department of Revenue. So the Board is stepping way out to say that not only does it want to have direct communication with the actuaries, but it has made sure that the departments get a copy of everything requested of the actuaries to make sure that the ARMB is not asking questions that the departments are not aware of. She pointed out that the ARMB is not asking the same thing of DOA, that whatever management asks of the actuary has to be shared with the ARMB. The Board understands that sometimes there is privileged information that it is not privy to, and it is not the Board's responsibility to step into the department's administrative realm.

CHAIR ERCHINGER said she was very surprised by the expectation that the primary actuary is somehow the DOA's actuary and not the ARMB's actuary. She had never heard that articulated in her history on this board. That is a dramatic departure from any conversations that she ever heard of with regard to the role of the primary actuary, and she thought that was why the commissioner was getting this kind of surprised response to his May 13 letter.

MS. HARBO reiterated that Stuart Goering of the Department of Law was asked to review the charter the committee approved at the April 22 meeting, and she thought Commissioner Fisher had been looking at Mr. Goering when he asked for a legal review.

COMMISSIONER FISHER stated that DOA management did not talk to Mr. Goering about the changes he recommended to the charter, and so it was not like those changes reflected the department's concerns. Mr. Goering did not have time to discuss his recommended changes with the department prior to his vacation.

CHAIR ERCHINGER said that she had no problem with the proposed change to the second paragraph of the charter that strikes out the words "special legal." However, she thought that verbiage was taken from other areas, so it was not an attempt to slip something different in there. Secondly, she recalled the ARMB in the past recommending the hiring of special legal as it related to some investment reporting issues for real assets.

COMMISSIONER FISHER said it was completely appropriate to say the Board needs some specialized assistance that it did not expect the Department of Law to have. However, it was his understanding that the decision of whether or not to hire that special legal support rests with the attorney general.

CHAIR ERCHINGER said it was her understanding as well. She asked committee members, in preparation for looking at proposed charter changes next time, to focus on the scheduling of a pre-valuation entrance conference (bullet point B-1 on the second page). The words “Review Actuary” were inserted in there, which would presuppose that the committee would be meeting with the review actuary, and she did not think that would be productive. If the committee was going to eliminate the pre-valuation entrance conference with the primary actuary, then there is no need to have a pre-valuation entrance conference. The idea was to establish the timeline, general approach, understanding the assumptions, and so on. The word “Review” inserted makes the paragraph meaningless.

BOARD CHAIR GAIL SCHUBERT, participating by telephone, addressed the discussion about the term “State’s actuary.” She said the law that recreated the ARMB, AS 37.10.220(a)(10), contains a reference to the Board’s ability to contract for an independent audit of the State’s actuary not less than once every four years. There is also reference to coordination with the retirement system administrator to have an annual actuarial valuation, etcetera. She thought the inclusion of the words “State’s actuary” was derived from the statute itself, something for the trustees to consider, although she did not want to belabor the point.

MS. SCHUBERT remarked that as a CEO she had a concern with the second paragraph under section I on the first page of the charter. That paragraph states that the Actuarial Committee would have direct access to DOR and DOA management and staff. That provision could potentially create a conflict and confusion, in terms of staff who are employees of the State and report up to the commissioners and the Board. Some trustees may be retired from the state retirement systems, but trustees really have no place in the state system aside from being ARMB trustees. So that provision caused her angst. It did not have to be done now, but at some point she wanted that provision reviewed and changed in a manner that will not create conflict and confusion moving forward.

CHAIR ERCHINGER thanked Ms. Schubert for those excellent points.

MR. PIHL said he hoped Ms. Schubert would provide the proposed language change she just described. For the June meeting he suggested that the draft of the charter from Mr. Goering be updated by referring to the actuary as the primary actuary, and to include some wording about the committee assisting the Board in establishing and directing actuarial methods and assumptions. His other proposed addition was the committee assisting the Board in reviewing the actuarial billings.

Responding to Commissioner Fisher, CHAIR ERCHINGER said she intended to prepare one version of the charter document that has all the recommended changes in it, and the committee will have to go through and vote on them one at a time.

MS. SCHUBERT stated that procedurally the charter would go to the full Board with a recommendation from the Actuarial Committee. The Board would then have the ability to make changes. She would like to see the “direct access to staff” matter dealt with. Also, since the “State’s actuary" is a defined term in the statute, and "primary actuary" is not a defined term under state law, that needs to be dealt with as well.

CHAIR ERCHINGER said she would ask Mr. Goering the question as well, but the State's actuary is included in the statute, however, she could not find where the actual term "State's actuary" was defined. That is sort of at the heart of what people are having angst over: does the term State's actuary actually mean the Department of Administration's actuary, or does it mean the actuary that both DOA and the ARMB have hired to serve as the primary actuary? She added that it would be helpful if Ms. Schubert weighed in on that with Mr. Goering directly. The committee already approved a charter at the April meeting but agreed not to bring that forward to the full board until the Department of Law had reviewed and commented on it. That review is in hand, and the committee will take up the charter again at the next committee meeting prior to the June board meeting. If the committee is able to pass a recommendation for the full Board's consideration at that time, it will, and if not, then it would have to be postponed until the following full board meeting.

COMMISSIONER FISHER reiterated that he was not able to attend the June committee meeting, and he was a bit reluctant about that conversation taking place without participating. If there was some way to do it beforehand, he would gladly take part.

CHAIR ERCHINGER asked him to speak to Judy Hall about his schedule to see if it was possible to schedule an additional meeting solely for the purpose of taking up the charter. She queried the other members, and there was no objection to that plan of action. She thanked the commissioner for his input.

With a bit of time left before the lunch break, the CHAIR asked Mr. Slishinsky to continue his presentation.

B. FY2014 Valuation Reports (Continued)

3. <u>Reviewing PERS and TRS</u> (continued)
   <u>Valuation reports, including payroll reconciliation and payroll growth assumption; indebtedness assumption, amortization of unfunded accrued liability</u>
   MR. SLISHINSKY continued with the new roll-forward procedure for PERS. He described how the average annual salary for FY17 was determined, saying that at the April meeting he had explained that Buck's benefit calculation for part-time employees annualizes the pay to avoid a double reduction in the calculation of pension amounts for part-time employees (page 19). Buck made changes to both PERS and TRS to break out pay. They continue to use annualized pay for the benefit calculation, which is appropriate. Then, for contributions they use the pay that is not annualized. For FY15, which is the pay that is in the FY14 PERS valuation, it would mean using \$2.277 billion for contribution purposes, which is about 3.98% less than the salary Buck is using for benefit purposes. The difference is due to part-time employees.

   MR. SLISHINSKY said the \$2.418 billion salary on the next slide (page 20) ties to the number on page 19, which is the pay used for contributions for FY17. Buck collects data from the Division of Retirement & Benefits that is representative from FY14 pay, but in order to use it in the valuation they have to convert that pay to FY15 pay. There is some data work that Buck needs to do in order to accomplish that. When they do these calculations for FY17 they have to continue that through FY16 and FY17. That is the reason why the number that is used on page 13 is different than the number Buck would have in the PERS valuation year FY15. Another reason this is done this way is, because of the plan being closed, there is a difference in the pay amounts for the defined benefit (DB) plan members versus the defined contribution (DCR) plan members. Over time, as DB members retire and leave, they are replaced by DCR people. The calculation of pay amounts for FY17 has to be more dynamic and take into consideration not only the pay that is expected to be paid in FY17 but how that is allocated and broken down between DB members and DCR members.

MR. PIHL asked how Buck arrived at the PERS salary number of $2.277 billion for FY15. MR. SLISHINSKY said they took the FY14 salary amounts from the data DRB provided to them, and in the valuation they have to construct the active population as of the valuation date. The information that DRB maintains on total salary will include the salary that is paid throughout the year of FY14, so it will include people who were active in the beginning of the year that either retired or terminated or left service and did not have a complete year's worth of pay. It will include on the DCR side people who were hired during the year, who worked a portion of the year between their hire date and the end of the year. At the end of the year, in order to come up with an FY14 annual pay for all of the people who are active at the end of the year, Buck has to annualize the people who were hired during the year for purposes of determining an annual rate of pay on the valuation date. Part-time employees are treated separately, as described earlier.

MR. PIHL stated that $2.178 billion was the actual PERS payroll for FY14 on which contributions were made into the system, and that number represented what happened over the course of the year (people retiring and going out, other people being hired, etc.). For the next year, there will be retirees going out and new hires coming in, and that will be the real experience. To get to Buck's $2.277 billion salary for PERS, it has been escalated by 4.45%. He thought the objective should be what the payroll is that contributions are going to be coming in on. Referring to page 19 (PERS payroll numbers), he noted that the projected payroll numbers escalate every year in the 3% range but rise to 4.1% in the latter years.

MR. SLISHINSKY said that reflected a half a percent growth rate in the active membership. Prior to this valuation, the projected payroll growth rate was 1%.

MR. PIHL said retirees with fairly high salaries would be leaving the system and being replaced by new members at lower salaries. He said all of that had to be built into the overall rate of payroll increase upon which contributions will come into the system.

MR. SLISHINSKY said Buck's was an open group projection that adds people as people retire and terminate, with an element of a growth factor if the belief is that over time the population will increase. Buck changed the active member population growth assumption from 1% to 0.5% because of the information on page 17 (PERS active member population growth from 2005 through 2014). Since the financial crisis, there has been a minor decrease in the active population in the years 2011-2014. Prior to the financial crisis and through 2010, there had been increases anywhere from 0.35% to 2.71%.

MR. SLISHINSKY verified for the Chair that these were increases in the PERS member population but not necessarily increases in the salaries.

CHAIR ERCHINGER asked what the overall impact would be to overestimating the growth in members over time, because it has an effect on both the benefits and the contributions. Would that add conservatism to the projections over time or be less conservative?

MR. SLISHINSKY explained that it does not affect the calculation of the PERS liabilities at all because it is a closed group. The only thing Buck is using it for is to generate a total active population in order to determine what the contributions are as a percentage of total payroll, as specified in statute. Otherwise, Buck would not need to include the DCR people in these projections, and they could just work with the closed group.

While MR. PIHL still had more questions about how the payroll growth assumptions were calculated, he said he appreciated that Buck adjusted the salary base downward by using the actual payrolls reported by DRB and escalating them for growth. The change eliminated about $130 million of overstatement that was occurring previously.

MR. SLISHINSKY indicated that for FY15 that amount is $94.288 million, which is slightly less than 4% of the total. Prior, Buck had been using the pay used for benefits for purposes of contributions. They have not looked long term at the issue of part-timers. In looking at some of the data on page 18, it looks as though there has been an increase each year in Buck's projection versus the numbers that DRB has compiled. That leads him to believe there has been a slowing of the increase in pay. There also could be more people being moved from full-time to part-time for budgetary reasons during this period, but he has not verified that. It is possible, and it is possible that that could turn around.

MR. PIHL remarked that it could get worse, and that was the more likely situation.

MR. SLISHINSKY said that is the nature of the beast: actuarial projections are based on assumptions that you feel are reasonable. A lot of these assumptions are reasonable long-term projections, with the understanding that in the short term the experience can be better or worse. It is usually the short-term where this kind of volatility is seen. The payroll increase from FY08 to FY09 was 5.9%, in FY10 it was 5.1%, and in FY11 it was 3.6%. That averages out to 4.86%, which is higher than Buck's assumption. At that time, Buck's assumption was not high enough. Looking at the last three years, Buck's assumption was too high. He suggested thinking of it as Buck setting a 30-year assumption that is reasonable, but having to explain why it is different in the short term.

CHAIR ERCHINGER remarked that the ARMB has the same argument when setting its investment return assumption and when talking about interest rate assumption and inflation assumption. However, it seemed particularly strong in the case of the salaries that there is a nationwide pension problem where people are dealing with how to get these costs under control. People are not adding staff, and more often there are staff cuts. Referring to Buck's charts, she said that the initial increase in the salaries in the early years could be largely related to local governments and state government losing the defined benefit plan, so that people hired into the defined contribution plan perceive less stability in the job, not as rich retirement benefits, and they want to get higher pay. Further, looking at Alaska and other states facing budget problems, what people are thinking is a short-term problem may persist as long as the closed retirement system is being wound down. So it is not a three-year or five-year problem or even a ten-year problem; it is probably a 15-year or 20-year problem. It may be that the old percentages are no longer applicable, at least in Alaska's closed system. She would like to have that conversation at some point.

MR. SLISHINSKY said it also ties into the overall discussion about the amount of margin the ARMB is comfortable with and how much margin is too little or too much.

COMMISSIONER FISHER asked when Buck sees this in state governments on a national level if they see certain trends. Alaska is in the midst of what Buck might say is a short-term event, and they are trying to produce a long-term forecast. He wanted to know how states typically behave before and after a revenue shortfall event such as Alaska is in.

MR. SLISHINSKY responded that it is probably no different than the overall economy. In a growing economy there is growth in expenditures and tax receipts, and the budgets of any government entity are going to be dictated by the amount of tax receipts that are dictated by the strength of the economy. Part of the issue with funding a pension system is that when a recession occurs, not only do revenues drop, there typically is also a drop in the investment return on the investment side, which causes an increase in unfunded liabilities and an increase in payments of the actuarial rates to the retirement system. It is an inverse relationship between the tax receipts coming in and the amount needed to pay the pension cost, which is what many states and public plans have been dealing with over the past seven years or so.

MR. BOUCHER referred to the PERS active member population growth chart for 2005-2014 (page 17) and asked where 0.5% assumed growth in the population for 2014 rated in terms of state governments and similarly situated entities. He added that there are plenty of states that are portrayed as being stagnant, so he was curious.

MR. SLISHINSKY stated that there is typically a growth assumption in these kinds of projections. The average is 1%, but it can range anywhere between 0% and 2%. Buck only sees negatives for sensitivity testing, to see what that does for the funding picture over time.

MR. BOUCHER said the Board might want to consider sensitivity testing to get a sense of comfort about how maintaining this particular assumption changes things.

MR. SLISHINSKY said he typically would not expect a long-term decrease in an active population over a 30-year projection period to be reasonable. There is plenty of data that forecasts the expected increase in population state by state. Typically, over time there is a relationship between a state's population and the size of state government and municipal governments that are there to support public service for that population.

MS. THOMPSON referred to the PERS payroll number of $2.277 billion for contribution purposes for FY15, as well as $2.344 billion for FY16 and $2.418 billion for FY17. She asked if she was right to be concerned that the $2.418 billion number for FY17 has a half percent population increase in it, and if the PERS population remains stagnant, then the contribution rates have been set too low. She added that the Board set the assumption of a 0.5% annual population growth.

MR. SLISHINSKY pointed out that it was set only in terms of the Board adopting the experience analysis, recognizing that the member population growth assumption was previously 1.0%, and the new assumption represents a half-percent drop from that. The only place that assumption is used is in the 30-year forecast. But in the forecast of the salaries in this projection, Buck is using it to come up with the pay in FY17 for the new roll-forward methodology.

MS. THOMPSON stated that GRS has a number of clients, in this economic environment, that have moved her to using a zero population growth assumption for the 30-year forecast. It depends on the purpose of the measurement, and her clients are not setting a contribution rate necessarily but are just looking at the future. The ARMB is setting a contribution rate, so that is a different purpose in the measurement.

CHAIR ERCHINGER said that was an important point, and she hoped that could be a future discussion topic.

MR. PIHL remarked that Alaska was looking at budget cuts, and school boards across the state are announcing cuts.

CHAIR ERCHINGER suggested including the population growth assumption in the later sensitivity analysis of assumptions: it would be a good one to look at first in the future.

Lunch break was called at 12:10 p.m., and the meeting reconvened at 1:25 p.m.

3. Reviewing PERS and TRS (continued)
Valuation reports, including payroll reconciliation and payroll growth assumption; indebtedness assumption, amortization of unfunded accrued liability
MR. SLISHINSKY said he was almost done with PERS, and similar factors applied to TRS, but there is an issue on TRS that he wanted to bring to the committee's attention.

Regarding PERS, MR. SLISHINSKY stated that he understood the committee's request was to remove the payroll growth assumption from the salaries in FY17, which will reduce that total by about 1.0%. Buck will return in June and show the results of doing this calculation with the reduced payroll.

CHAIR ERCHINGER inquired about reducing the $439 million for the PERS healthcare liability. It is a change from the current healthcare cost trend rate assumptions, and she preferred not to make assumption changes without the Board voting on them. She noted that no one from the Department of Administration was present to weigh in on that issue, but she was hesitant to continuously bounce around those assumption changes. Trustees do not understand the full impact of them and have not been able to vet why it is prudent or not prudent to make those changes. She personally did not support the healthcare change at this time without further discussion. She acknowledged that it puts the actuary in a bind, being stuck between the Board and the Department of Administration, which is why she hoped a workable solution could be found through this process to address these issues and make sure that everyone is on the same page.

MR. SLISHINSKY stated that Buck could put together the roll-forward procedure under the old healthcare cost trend rate and the new healthcare cost trend rate, and the committee and Board could look at both as a comparison. CHAIR ERCHINGER said that would be helpful.

MR. SLISHINSKY moved on to page 14, saying that Mr. Trivette at the April meeting had asked for a reconciliation of the roll-forward of the unfunded accrued liability showing the pieces of it and how it all works. The April discussion had included how the level percentage of pay method has a negative amortization. He then explained the PERS roll-forward calculation for FY15 in detail.

MR. PIHL commented that Buck was essentially amortizing actuarial gains and losses over the remaining years. MR. SLISHINSKY said the statute states a fixed 25-year period, so Buck interprets that to mean one year afterward it becomes a 24-year fixed period, and then a 23-year fixed, etcetera.

MR. PIHL said the legislature's direction was also to eliminate asset smoothing. He thought the committee needed to have a discussion of alternative ways to deal with that actuarial gain or loss, as opposed to stretching it out to 25 years. He believed the legislature's intent was to recognize the actuarial gain or loss on a quicker basis by eliminating smoothing.

MR. SLISHINSKY said that eliminating asset smoothing it is really using fair value of assets.

MR. PIHL responded that the asset smoothing could be spread over three years. MR. SLISHINSKY agreed it could be smoothed over three years instead of five years to recognize the gains or losses faster. MR. PIHL added that to take it into the system for five years and spread it over 25 years could be snowballing it, and he did not think that was what the legislature wanted.

MR. PIHL said he was going to make a motion to eliminate asset smoothing and follow legislative intent, and the ARMB will either adopt it or not.

CHAIR ERCHINGER asked Mr. Pihl to be clear if he meant just the investment gains or losses, or if he was talking about all the actuarial gains or losses.

MR. PIHL said he was thinking just of investment gains and losses because that is the big one, but it could apply to the whole experience.

MS. THOMPSON stated that currently Buck is smoothing over five years and then amortizing over 25 years. She ascertained from Mr. Pihl that he advocated smoothing investment gains and losses over three years, period, and no amortization.

MR. SLISHINSKY pointed out that that proposal was not in accordance with state law HB385, which is to amortize over a closed 25-year period from June 30, 2014. He said that gains and losses, whether they are investment or demographic, create gains or losses.

MR. PIHL said he thought the legislature was dealing with the unfunded liability as of June 30, 2014, and the changes to that year-by-year going forward are another thing.

CHAIR ERCHINGER inquired what the interpretation was of eliminating smoothing.

MR. SLISHINSKY said to mark assets to fair value as of June 30, 2014. His understanding is that it was included in SB119, and not HB385, and it was an intent, which is not legally binding.

CHAIR ERCHINGER said she was trying to find out if the legislative intent was as Mr. Pihl stated (recognize all the gains in one year, with the $3 billion appropriation thrown in, and then eliminate smoothing). Her interpretation was exactly what he said. What Mr. Pihl has said is consistent with the other actions that the legislature took, which was to eliminate the two-year lag (which is more timely information, and not have to roll stuff out into the future, and fix it now). So whether that is recognizing investment gains this year and having lower rates next year, or whether it is recognizing all the investment losses this year and having higher rates next year. ARMB trustees have not been involved in the conversations about what eliminating smoothing means, and so they still have questions. It is important for the trustees to understand what is meant, what decision was made, and what the impact is of that decision. It sounds like the process is going back to the way it was done before the legislature put in that language.

MR. SLISHINSKY submitted that Buck was recommending restarting the process. Just because that is their recommendation does not mean the ARMB has to do it. The Board could interpret the statute to mean that only the existing unfunded liability as of June 30, 2014 is amortized over a fixed 25-year period, and then any changes thereafter, whether they are come from actuarial gains or losses or changes in actuarial assumptions, can be amortized over different periods. That is an interpretation of HB385. The intent is a matter for the legislature and probably for the attorney general’s office.

CHAIR ERCHINGER voiced her belief that this committee has not had an opportunity to weigh in on that decision, and so the committee is hesitating to take ownership of making that decision of whether or not to follow legislative intent. Her reading of the valuation report is that the ARMB has approved the actuarial assumptions, and one of those things is to go back to asset smoothing. She asked that if the ARMB does not take any actions that that piece of the dialogue be made clear that the ARMB did not weigh in on that issue. Either the Board weighs in on a decision, yes or no, or the Board does not weigh in but also does not take credit or blame for doing anything with whatever was the legislature's direction.

MR. BOUCHER remarked that hazarding a guess on legislative intent is always hazardous. His commentary, based on conversations he has had since that time, is that the moves were made to capture as much of the asset gains as possible at that point in time. His interpretation of the conversations is also that the ARMB was given wide latitude with just about every other lever that is available to it, except for two things, and those were spelled out in statute: that level dollar was off the table for the legislature, and the 25-year amortization. Based on the legislature's silence and putting it in intent rather than statute, he believed the Board has its normal purview in choosing its path forward in these questions the committee is debating now. If one were to ask each of the people who were closer to the finance committees at that point in time, they might each come at it with a slightly different flavor as to what they envisioned going forward, and perhaps they could not even come to a consensus and left it in the hands of the people who have made the decisions traditionally, with the exception of those two items.

MR. SLISHINSKY, referring to page 26 in the presentation slides, updated the committee on an issue Buck uncovered on TRS. Buck's payroll numbers for TRS are much lower than what DRB reported. Delving into why that would be, Buck came to the conclusion that the data they receive as of June 30th oftentimes includes continuing teachers and teachers that terminate during the year, but may not, in some instances and for some school districts, include new teachers that will working in the fall to replace those that have left. In some cases, there are teachers whose contract expires, who get registered as terminations, and then get a new contract for the next year after June 30th and work for the next school year. It seems like Buck is missing some TRS people, and many of them (new hires) are defined contribution plan people. So there are some issues with the data that can explain why Buck is about 10% low on the TRS payroll projections.

MR. SLISHINSKY said Buck has decided to get a supplemental data tape for TRS and focus on matching that data with the information already received to see if they can glean out some new people that started work in the fall.

MS. RYAN stated that teachers are hired in August, once budgets are decided by boroughs and school districts. By most contracts, teachers are terminated at this time of the year, and then as monies come in from the entities those teachers are reinstated, even though they may appear originally as terminated. She recommended not even looking at teacher numbers until August, if at all possible, or even September. There is usually another push in September because there are gluts in some areas and shortages in other areas, creating a movement of physical bodies, but it usually results in a net gain of a few teachers here and there.

MR. SLISHINSKY said the options are to get the June 30 data run and then do another supplemental at September 30, or to just wait until either the end of August or the end of September and get one data run.

MS. RYAN said she thought the numbers would be continually non-representative as there will continue to be budget issues until boroughs fully fund education. She felt that data from mid August would be off probably by only a few percentages. September 1st would probably be safe as well.

MR. WORLEY suggested waiting until September because teachers may be hired in August but not show up in the system until September.

MS. HARBO remarked that sometimes teachers are not hired until October.

CHAIR ERCHINGER noted that Buck was also recommending reducing the TRS active member population growth assumption from 1% per year to 0.5% per year for projections in 2014. The discussion earlier for PERS had been about looking at long-term trends and not so much short-term. She did not see why there should be any increase projected short term, and the projection could be for decreases. Quick math shows at least 1,500 public employees in Alaska are going to be laid off, not including any local government employees who will be laid off in the coming year. She thought teachers were one group that would be hit the hardest, and she did not see the reason to project TRS member population increases at all.

MS. HARBO said the number of active teachers has decreased significantly over the last ten years, and she thought the number would keep going down as the student population goes down with the slowing state population growth rate.

MR. SLISHINSKY stated that the data has indicated that there had been growth in the active number of teachers through 2010, and then there has been a steady decline. TRS is similar to PERS in that way. He could not say, with the financial crisis, budgets and demographics, whether this is a long-term trend or a short-term trend.

MR. TRIVETTE asked if the ARMB should be using the 0.5% TRS member population growth assumption and what the impact would be of doing that. MR. SLISHINSKY said he had thought about going with no growth at all or half a percent: the 0.5% seemed reasonable for PERS, and zero percent for TRS seemed reasonable, but then he had to ask himself long term over 30 years if he could still expect there to be absolutely no TRS member population growth. He came down on the side that 0.5% is a reduction from 1%, which is how he arrived at the recommendation.

MS. RYAN remarked that the ARMB could look at this assumption again in a year and change it. She strongly recommended the TRS population growth assumption be zero for projections in 2014 because she did not see any growth in the next year or two.

CHAIR ERCHINGER requested that Buck prepare the roll-forward for TRS both with and without the change in assumption for healthcare liability reduction, and also to remove the population growth assumption and run those numbers (similar to the earlier request for PERS).

4. <u>Discussion: Identifying Assumptions with Greatest Adverse Impact if Actual Experience Varies Significantly from Assumptions</u>

CHAIR ERCHINGER stated that when talking about how this committee is going to best impact the actuarial review process, it would serve the committee well to have a better understanding of the major assumptions that have the biggest impact so they know where to spend most of their time initially.

MR. SLISHINSKY referenced the February 2014 board meeting when Larry Semmens, a former board member, addressed the Board. Mr. Semmens had asked that question, and Mr. Slishinsky had told him the most impactful assumption in the actuarial valuation was the discount rate, which is intended to be the long-term rate of return on investments. The second most impactful assumption was mortality. If he had been pressed for the next assumption that has the most impact he would have said the healthcare cost trend rate. Those three assumptions are a good start.

CHAIR ERCHINGER asked about asset allocation. MR. SLISHINSKY replied that asset allocation affects the discount rate. The interesting thing is that when the Board sets its asset allocation policy it should be very cognizant of the amount of risk involved in the chosen asset allocation. While not true in the ARMB's case, he has heard some investment consultants working with retirement boards who look at what the actuary says the discount rate is and then try to determine an asset allocation that in the next year or two will achieve that rate of return. That is backwards. Buck sets the discount rate based upon the ARMB's asset allocation decision. The more risk in the asset mix, the more likely the retirement fund will get a higher long-term rate of return, and that influences the actuary's decision on what to recommend for the discount rate.

CHAIR ERCHINGER said she agreed on the three assumptions that Mr. Slishinsky identified as probably the most impactful. Regarding the short term, she asked about the investment return assumptions that are being used in the new roll-forward procedure. For example, if the actual investment return was only 2% when the earnings assumption in the roll-forward calculation was 15%, would that impact only the rate setting for the next year or have an impact beyond that?

MR. SLISHINSKY responded that any difference in one year causes a gain or loss. For instance, last year the retirement fund earned 18.1%, and that big gain is baked into the calculations. It is why the unfunded liability went from $7.4 billion down to $6.2 billion. The discount rate is set looking at the long term, but there will be short-term volatility. The volatility on the investment side can be significant and is one of the reasons for asset smoothing.

MR. SLISHINSKY reported that he found a Milliman study that included data that showed the market value and actuarial value of the top 100 public retirement systems. Out of the 100, there were only three systems where the market value and actuarial value were exactly the same, indicating the systems that were using market value. The rest had some other methodology for determining assets that was different than market value. Two of the three that were using market value were Puerto Rican retirement systems, one of which had a funded ratio of 4% and the other had a funded ratio of 21%. The third one was West Virginia. All of those funds had very low funded ratios, which were driving them to not smooth at all but instead want to know the market value of assets and how much more they have to put in.

MR. PIHL wondered how many of the top 100 public retirement systems were closed systems. MR. SLISHINSKY said the closed system is expected to have cash flows out to 2109, so it still has a lot of legs on it. MR. PIHL said it is a question of when do people want to get it fully funded.

CHAIR ERCHINGER remarked that it was a different issue. She said some people are thrilled about going to level percentage of pay methodology because it gives great relief to the state budget, and now assets will be smoothed to get rid of some of the volatility. The other camp says that level percentage of pay will require state assistance contributions to go from $74 million to $250 million or so at a time when there isn't the money. There is tension about how conservative the ARMB should be. The bottom line is this committee believes that the more money into the system earlier, the better. Every little assumption that drops the contribution rate further tanks the committee's ultimate strategy. It is stepping over dollar bills all day to pick up pennies everywhere, but it is not getting the committee to where it wants to be, which is a better-funded system that will be able to pay for benefits. Somehow the committee has to come to a better understanding of what its end game is and come up with a strategic plan that works, rather than beating to death every assumption.

MR. PIHL stated that for PERS and TRS combined the interest on the unfunded liability is about $2 billion a year. If the question was taken to the people of Alaska, they would want to do something about it and get that accruing debt off their backs sooner. If 2% of the earnings of the Permanent Fund were dedicated to paying that debt for eight years, it would eliminate the unfunded liability. He thought the legislature had that authority.

MR. PIHL said he wanted the payroll growth assumption added to the sensitivity list, particularly with percent of pay methodology directed by the legislature. He put this in the data category and thought the Department of Administration should be responsible for surveying about a dozen communities across the state to find out what was going to happen to their payrolls in the next year.

MS. THOMPSON voiced her opinion that it is the discount rate, mortality and salary scale that are influential assumptions for adverse impact. Also the trend and retiree participation rate on the medical side (whether a member is in or out of the plan is a big lever on the liabilities). When it comes to the question of what is the most important, she leaned toward doing an economic assumption study because inflation is imbedded in salary, payroll growth and discount rate. Buck could look at that in an integral and holistic way.

MR. BRICE suggested having the assumptions that were identified as potentially having the greatest adverse impact ranked by the level of impact they may have.

CHAIR ERCHINGER agreed, adding she liked that the review actuary's recommendations for the ARMB to look at a particular assumption also included the actuary's impression of whether it was a material impact to the retirement plan or was less important. She still wished to follow up on recommendations with more minor impacts, but the main goal as this committee begins its work should be to focus on the bigger picture assumptions.

5. <u>Develop Plan for Action on Review Findings – both Historical and in Current FY2014 Review Report</u>

CHAIR ERCHINGER mentioned the process the Board uses to address the recommendations in the reviewer's report of the ARMB performance audit done every few years. In that case, staff goes through the report systematically and brings to the Board resolutions recommending particular modifications or to make no change. That approach has worked well for the investing side of responsibilities. She proposed using a similar approach to the recommendations from the reviewing actuary. Either the committee or the reviewing actuary could prioritize the recommendations. Then the committee could discuss each of those recommendations in depth with the review actuary and primary actuary, and over time, bring forward resolutions from the committee recommending to the full board to accept a particular assumption change or not, or to make other changes.

MR. TRIVETTE said the performance audit review process was a successful model, as long as it was done in a more systematic way, without big gaps in time in looking at recommendations.

MR. PIHL said the first thing to address is to put a price tag on the assumptions to judge their significance. GRS has recommended to the ARMB over the years that the discount rate or interest assumption be lowered.

CHAIR ERCHINGER stated that the discount rate was an in-depth issue and would require a presentation to the committee or probably at the full board level. Her perception was that this item was not time critical.

MR. TRIVETTE mentioned that the investment consultant and Investment Advisory Council members would have valuable information on the discount rate issue to share with the Board.

CHAIR ERCHINGER said she was willing to revisit that issue, but Callan has presented on it, and the last time the Board discussed it she was not the least bit compelled that the ARMB needed to consider a change in the discount rate. Whatever the Board decides will be on record, and GRS can check off that the Board has dealt with that issue. She believed that part of the due diligence of the ARMB is to take under advisement the recommendations of the actuary and the review actuary for assumption changes and make decisions about them.

MS. THOMPSON stated that the discount rate is made up of inflation and real return. Inflation is imbedded in salary scale and payroll growth, and it is in the medical trend. She would be nervous studying just one assumption and changing one assumption without paying attention to the other assumptions, because they are all related. She said her written comments came out as a result of the experience study. If the ARMB does not want to wait four years until the next experience study, she has other state clients that do an interim economic study of inflation, payroll, salary, all the things that are correlated.

MR. BADER recalled that the committee and others wrestled with this issue for quite some time five years or more ago. That resulted in taking the earnings assumption from 8.25% to the current 8.0%. He thought that ever since that time the ARMB has attained the earnings assumption. The Board does an asset allocation every year, after hearing Callan's numbers for expected return and expected standard deviation, etc. and considering the recommendation from staff and the IAC. It is all based upon those assumptions. For some reason, there is a visceral feeling behind why people think the earnings assumption is high. Time will tell if it is high or not. But one thing that can be done is to use Callan and JP Morgan and the different assumptions for different firms and tell the ARMB the probability of what should happen over time. That is not betting upon a visceral feeling of what to expect over time, because nobody knows what inflation will be over time. He cautioned about changing something as powerful as an earnings assumption, and the collateral impacts it will have right after getting $3 billion into the retirement systems. It will be hard enough to explain to the legislature why the unfunded liability is going up, even if the retirement funds earned 8.25%. He understood why the actuaries were in favor of lowering the discount rate, but they are always on the conservative side.

CHAIR ERCHINGER suggested reminding the Investment Advisory Council members that the committee is still interested in the earnings assumption issue and would like them to weigh in on that issue periodically in case their recommendations have changed. If there is any indication from the IAC or Callan that the ARMB may not be able to achieve the current return assumption long term, then the ARMB should definitely revisit the question.

MR. TRIVETTE proposed giving the IAC members a couple of months' notice to prepare their comments. He recalled that GRS did recommend a lower earnings assumption, but Ms. Thompson also wrote about some of the things the ARMB has done that support going outside GRS's recommendation.

CHAIR ERCHINGER said the real return target is 4.88%, which assumes 3.12% inflation, so she did not feel the need to review that assumption because of the combination of those two parts. However, she realized the return assumption was a huge driver of the whole plan, and she was open to a review if people wanted to do that.

Regarding the appropriateness of the mortality tables being used, CHAIR ERCHINGER said it seemed that GRS's report mentioned the tables were not generational but static. She asked for an explanation in the near future.

MR. SLISHINSKY, responding to Ms. Harbo, said all the private plans have to use the new mortality table the IRS is adopting for 2017 or 2018, but he did not know of any public plans that have adopted it yet. He agreed with her that adopting the new mortality table would definitely increase the unfunded liability and the normal cost. There are some philosophical issues surrounding that table as well, and some complications in understanding how that table works. It is two-dimensional, so not just based on age but on when you turn that age.

MS. THOMPSON stated that she was trying to get GRS clients all moved to fully generational mortality tables, so not projected to any year. The primary question for her is whether the mortality table used is fully generational, and there are different tables that can be used to project. The Alaska mortality table is fine but it is not a best practice.

CHAIR ERCHINGER proposed making the mortality assumption the first major topic of conversation, with the two actuaries providing the different perspectives to educate the committee about the use of the different tables. She suggested moving in the direction of starting to identify the assumption changes that are being recommended, and the committee weighing in on whether or not to accept those recommended changes. She had a question around what to do with the GRS recommendations where Buck does not have the capability of implementing a change because of system limitations.

CHAIR ERCHINGER said it would be helpful if Ms. Thompson could prioritize the issues she is most concerned about that have material impacts to the retirement plans. MS. THOMPSON indicated that was possible.

MR. PIHL asked if anything was forthcoming on retiree healthcare participation rate. MR. SLISHINSKY said Buck is currently using 100% participation rate, although the actual rate is less. They could run the calculations based on 94% participation to show the outcome so the committee has a sense of how much margin there is in the 100% assumption.

CHAIR ERCHINGER summarized that the committee did not need to see payroll growth assumption increases; and they are interested in looking at the range of impacts from payroll growth reductions, and whether the reduction is down to zero or at least in the short term something less than zero.

MS. THOMPSON pointed out that Buck was recommending reducing the retiree medical inflation rate on the retiree medical contributions.

CHAIR ERCHINGER proposed that as a discussion topic for the next meeting. She asked committee members to be patient as she and staff build the meeting agendas, because some items depended on when people were available to make presentations, consult with, or answer questions.

CHAIR ERCHINGER asked if there had been committee agreement that the model the Board currently uses for addressing performance audit recommendations would work for the committee to address the reviewing actuary's recommendations and follow-up items. [It seemed there was agreement.] She left it open, if anyone had a simpler approach, to bring it up at the next meeting.

MR. BRICE suggested dealing with any potential assumption changes and bringing any recommendations to the Board one subject at a time, as opposed to presenting something like five proposed changes at a time in one resolution.

MR. PIHL added that that approach would apply to all changes in actuarial assumptions and methods: coming through the committee to the full Board for approval and direction to the actuary. He advocated that no changes be made without the process.

CHAIR ERCHINGER said she agreed with that comment, but if this committee was recommending that the actuaries make no changes to actuarial assumptions unless directed by the Board, then that direction needs to be brought forward as a recommendation from this committee to the full Board where the Board acts upon it. Then, the full Board has spoken to the actuaries as to how to proceed.

Committee members voiced their support for that procedure.

MR. BOUCHER raised the case of the Society of Actuaries stating that something should be done a certain way from now on. He would implore the ARMB to empower Buck Consultants to implement best practice and to bring those recommendations forward, as Mr. Slishinsky has in the past. He wondered if even those types of things would rise to the level of Board approval. The ARMB has approved singular changes but has also made changes via the experience analysis, where a number of tweaks have occurred. He was a bit worried about a policy of making only single assumption changes, and he wanted to strike the right balance for the Board to be productive. Judgment would come into play on the materiality of the assumption in play.

CHAIR ERCHINGER thanked him for that perspective, and added that she was trying to avoid off-the-cuff instructions to the actuary. She agreed that a balance was needed.

MR. BRICE cited the mortality table discussion earlier, where one actuary was using a certain table for the mortality assumption and the other actuary was recommending the mortality assumption be based on a different type of table. He felt it was important that this type of information be reported to the committee in a clear manner and not found as a footnote buried in a report.

CHAIR ERCHINGER stated that understanding the timing involved in the actuarial process and reviewing actuary process was one factor when she was thinking of the pre-valuation conference. Then there is the question of how much time the Actuary Committee needs to do its review, after which the committee's recommendations have to be approved at the board level. The committee may have to rethink its meeting schedule, because many of the meetings take place the day before a board meeting and may not allow enough time to get items on the agenda. She said she would talk to Ms. Hall about the timing issue. A question is whether the committee is willing to meet outside the standard quarterly meeting schedule to accommodate that timing.

CHAIR ERCHINGER said a personal goal is to make sure that not only is the committee addressing all the assumptions and changes but also resolving the outstanding issues from the review actuary for the purposes of the actuary having some direction going forward, and not continually having these issues look like the actuary is not being responsive.

MR. PIHL inquired about getting some closure on the subject of the GEMS model.

CHAIR ERCHINGER said she thought the Investment Advisory Council had a good discussion on the GEMS model at the last board meeting. Prior to that, she had not felt like she knew anything about the model. She believed the IAC was endorsing the use of the GEMS model, as recommended by Buck Consultants.

MR. PIHL asked to hear from Mr. Bader on this. MR. BADER said there was a discussion between the IAC, Ms. Hall, himself, and some of the experts at Callan Associates in setting up the topic for the board meeting. The view was that the GEMS model is a useful tool to be used alongside the methods that Callan presents. They did not fully embrace it as being a better way to go, but there is good information from the model. He offered to provide the information letter about GEMS that summarized the discussion for the Board.

CHAIR ERCHINGER asked Mr. Bader to do that for a future meeting so the committee could address the topic for the reviewing actuary.

C. Further Meeting Schedule – 2015-2016 Committee Schedule

A discussion ensued about the feasibility of scheduling another meeting that would precede the scheduled June 17 committee meeting, because Commissioner Fisher had indicated he would be unavailable for that meeting, and the charter amendments would be on that agenda. MS. HALL was asked to canvas everyone to see if it was possible to hold an early June meeting to take up the charter. CHAIR ERCHINGER said if it was not possible, then the charter item would have to be delayed.

MR. TRIVETTE inquired about the May 7, 2015 letter from Buck that was given to staff but the committee had not seen yet. He guessed it would be something for the June meeting.

MR. SLISHINSKY stated that it was Buck's response to the reviewing actuary's issues in the supplemental report. The committee could comment upon it in June.

CHAIR ERCHINGER said there were a lot of items for the June meeting agenda already, and there might not be enough time to cover them all. She would try to prioritize the items and circulate a proposed agenda to committee members.

MR. BOUCHER ventured that the commissioner would say that if the June meeting had to go forward and table the charter discussion that he would prefer the committee's work go forward absent a charter. The committee is currently doing important work without conclusion on the exact wording of the charter.

CHAIR ERCHINGER commented that the committee has a charter in place, for better or worse.

Responding to Ms. Harbo, CHAIR ERCHINGER said she and Ms. Hall would work on the date and agenda for the August meeting and talk about it at the June meeting.

MS. RYAN said she had a conflict with the June meeting for grading AP tests, and that troubled her. She could probably call in for part of the meeting if it was in the afternoon. Regarding August, the earlier in the month the better, because school starts in August.

CHAIR ERCHINGER noted that review of the National Guard and Judicial retirement systems, as well as the defined contribution plan, were on the June 17 agenda. She urged everyone to read all the materials beforehand so things could move along.

OTHER MATTERS TO PROPERLY COME BEFORE THE COMMITTEE – none.

PUBLIC/COMMITTEE MEMBER COMMENTS

MR. PIHL thanked the Chair for her leadership on this work.

MR. TRIVETTE said it was a great start in the last month, and he thought it would be a good year before the committee got everything laid out time-wise and going in the right direction.

MS. RYAN thanked the actuaries for doing an excellent job and being able to respond to committee member questions so readily.

ADJOURNMENT

The meeting adjourned at 3:10 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, staff reports, and written presentation materials on file at the ARMB office.

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