State of Alaska
ALASKA RETIREMENT MANAGEMENT BOARD
ACTUARIAL COMMITTEE MEETING

Captain Cook Hotel
Voyager Room
Anchorage, Alaska

August 14, 2015

ATTENDANCE

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

Committee Absent: Tom Brice *(due to illness)*

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

Department of Administration Staff Present:
John Boucher (deputy commissioner)

Others Present:
Dave Kershner (Buck Consultants, actuary)
Todd Kanaster (Buck Consultants, actuary)
Leslie Thompson (Gabriel Roeder Smith, review actuary)

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

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

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

IV. APPROVAL OF AGENDA

MS. HARBO moved to approve the agenda and MR. TRIVETTE seconded. Without objection, the agenda was approved.

V. PUBLIC/MEMBER PARTICIPATION, COMMUNICATIONS AND APPEARANCES

There were no appearances before the committee or any communications.

VI. APPROVAL OF MINUTES – June 17, 2015

MS. HARBO moved to approve the minutes of the June 17, 2015 meeting and MR. PIHL seconded. There were no changes, and the minutes were approved.

VII.

A. Valuation Process Outline

CHAIR ERCHINGER noted that this was the committee's first meeting of this type, which was an opportunity to learn about the actuarial process. She welcomed David Kershner of Buck Consultants, who was replacing the retiring David Slishinsky. She also acknowledged Todd Kanaster, with Buck as well. She said the committee wanted to better understand how the valuation process and timeline work so the Alaska Retirement Management Board (ARMB) can fit the actuary's work into the board's meeting schedule.

MR. KERSHNER said he looked forward to working with this committee, the ARMB, and the reviewing actuary (GRS).

1. General Overview of Valuation Process

MR. KERSHNER stated that the Alaska experience is unique. Most or all of Buck's public retirement systems do the valuations and experience analyses, review the assumptions, and then make recommendations, and the board approves them. At some point after that, usually an independent actuary reviews the most recent valuation, provides comments, and there is some back-and-forth. At some future point, after the valuation is completed, those issues are discussed, and any changes to the assumptions or methodologies are then incorporated into the following year's valuation.

In Alaska's case, the actuary and reviewing actuary are working basically parallel. This undoubtedly extends the timeline of the process for completion because there are extra steps in between. Most public retirement systems have an actuarial audit that is done maybe once every three, four or five years. For Alaska, it is done every year, which is different, as is the fact that it is being done at the same time as the actuarial valuation work.

MR. KERSHNER explained that for most of Buck's July 1 to June 30 plan year retirement system clients they produce final valuation results in the October-November-December time frame. Buck does not have that in Alaska's case because of the extended process. He said Buck created a timeline chart to give the committee an overview and a sense of how Buck is trying to accelerate the process this year compared to what has been done in the past.

MR. KANASTER referred to a Buck Consultants slide of a chart entitled "Overview of Valuation Timelines for PERS/TRS for 2014 and 2015" *(on file at the ARMB office).* He said the intention was to speed up the process, with a goal to get draft defined benefit reports for PERS and TRS before Christmas. Buck started with requesting data a month earlier than last year, and Kevin Worley in the Division of Retirement & Benefits (DRB) is working hard to get the data to Buck by the September 1 deadline or even a week earlier. That would be a huge help. He referred to deadlines for Buck sending data questions to DRB and getting data answers back, and how they have talked about focusing more on questions that involve the liabilities and bigger items, rather than sending 30 pages of questions that focus on items like a member's birth date. Buck believes that minimizing the back-and-forth will help speed up the data process.

MR. KERSHNER said they are trying to focus on the bigger picture and the overall materiality of the differences. For example, if there is a group of people where the salary is missing and this will delay the process, if the group is small enough, Buck can impute a salary that is equal to the average salary for a similar group or similar employer. In the overall scheme of things, somebody's salary has an immaterial impact on the overall valuation results.

LESLIE THOMPSON of Gabriel Roeder Smith (GRS), the review actuary, referred to the "30 pages of questions" comment and asked what Buck thought the number of questions would go down to under this new process. MR. KANASTER responded that they would see, but he has reviewed some of the data questions from the prior year and found lots that were terminated/non-vested and when did they terminate: that does not affect the valuations, so he would cross those out. He found that he was crossing out quite a few and cutting the process down. Buck will keep the accuracy and make sure they are checking all the data for reasonableness and consistency with last year, and they think they can reduce the number of times they have to contact DRB.

MS. THOMPSON asked if Buck would indicate if they imputed something like the salary example just given. MR. KERSHNER said they would clarify exactly what they did.

MR. KANASTER stated that while the analysts are putting together the valuations he can be putting together Buck's projections at the same time. The typical process has been to provide the State with draft results without projections, and, following review, Buck provided draft results with projections. Buck is trying to minimize that back-and-forth communication. Buck intends to provide draft valuation results with projections for the December meeting.

CHAIR ERCHINGER asked if Buck conducted its work and then handed it to GRS for review, or if they were able to give GRS the test lives they picked, for example, so GRS could start checking the information. MR. KANASTER replied that Buck does not need to have the draft report done. They do their own internal checks first in order to be confident about the liabilities. Once that is done, they can print out the test lives and forward them to GRS. MR. KERSHNER referred to the timeline chart showing the end of November as the target date for providing GRS with a response to their October 15 audit data request. By that time, Buck will have gone through and resolved any inconsistencies between the data from last year to this year, and they will be comfortable that the data to be used for the valuation is reasonable and consistent. They will not wait until getting everything done at the very end; things will be going on in parallel. MR. KANASTER added that that is a breaking spot in the valuation, when the data is done and it is time to start the liabilities, so they can give GRS the data.

MR. KERSHNER referred to the target of the third week of April for the Actuarial Committee meeting to review the draft valuation reports and prepare for the June ARMB meeting. Last year that committee meeting was the middle of June.

MS. THOMPSON mentioned Buck's earlier comment that the concurrent nature of the audit was slowing Buck down. MR. KANASTER said it was one thing. MS. THOMPSON asked which items, if not done, would collapse the schedule. MR. KANASTER pointed to between the draft valuations and the finalization, between steps 20 and 23 on the timeline chart. That is when Buck receives audit reports from GRS: last year that was May-June, which is when Buck can start finalizing the reports, and now they are anticipating late March.

MR. KERSHNER said that in another situation, where the actuarial audit is done outside of the valuation process, Buck would not have steps 20-23, which is reviewing the GRS audit report, responding to GRS, and then reflecting if there are any issues that then get swept into the draft valuation reports for the Actuarial Committee meeting in item 24.

Chief investment officer GARY BADER stated that one item that has slowed the process considerably in the past is that until Buck's work is complete and has been reviewed, it has not been provided to the Department of Revenue to send on to GRS. Many times it has felt like there was not time for GRS to do their review between the time they got the finished product and the board meeting date. He understood that Buck and GRS would be working in parallel now.

MR. KERSHNER said Buck was accelerating the process such that the draft DB reports with projections that are provided to the DRB would get reviewed and sent from DRB to GRS by January 8. Then GRS is targeted to provide their audit report for the DB plan in late March. So Buck is allowing for that process to be run in parallel. By doing items earlier, and taking out some of the steps that Mr. Kanaster referred to, Buck can then get the information to GRS earlier to give them more time to do their work before the board meeting.

MR. BADER said he applauded anything that would get the materials to GRS in time for them to do a thorough job.

MR. PIHL asked what was keeping this in a parallel approach as opposed to the normal approach. He guessed that the normal approach would be considerably less costly, and the ARMB would get the final reports months earlier. He wanted to see a possible timeline on the normal approach.

MR. BADER responded that this approach is dictated by Alaska statute that requires the review from the reviewing actuary *prior* to presentation of material to the Board. In addition to the GRS review, a full actuarial audit is required every five years.

MR. PIHL remarked that one solution would be to change the statute. He added that he has observed that Buck has not been as quick or apt to respond to GRS points. They also have not been as responsive to the points he has made about the PERS payroll base being too high by $60 million, which projected out 25 years is a big problem. He found that frustrating. He hoped that would change with new leadership.

Addressing Mr. Pihl's last point, MR. KERSHNER stated that that is one of the things that is done before Buck gets too deep in the process. Buck does not have the ability to know if the payroll number they are getting is $60 million too high or $60 million too low, other than comparing it to previous years to test for consistency and reasonableness. MR. PIHL clarified that Mr. Worley gives everyone the actual payroll as of June 30, and Buck has not used it.

MS. THOMPSON noted that Mr. Kershner was not present at the last committee meeting. There had been a long talk about the payroll number at that meeting, and when she spoke with Dave Slishinsky, he did not have Mr. Worley's payroll. She suggested that Buck get Mr. Worley's payroll as an actual item in the data review process because what Mr. Pihl uncovered was extremely serious, in terms of the valuation. There are two payrolls: a rate payroll and a valuation payroll, which are different because of the treatment of part-timers.

MS. THOMPSON informed the committee that Mr. Slishinsky had uncovered something else regarding teacher payroll that is still unresolved.

MR. KANASTER said he would speak to that later in the agenda. Regarding the payroll, he said that Buck has two separate payrolls for the 2014 valuations, where they annualize the pay for part-timers to determine the liabilities, and then they do not annualize that pay to determine the contribution rate. He understood that that is what addresses the difference between the Worley payroll and the payroll that Buck is using. That being said, he wanted to get the payroll number that Mr. Pihl has seen to compare it with what Buck is showing, and to increase the communication on that.

CHAIR ERCHINGER said she liked Ms. Thompson's suggestion to add a new bullet point to the timeline in terms of Buck getting the actual payroll number from the Department of Administration to make sure what Buck is using is the most recent payroll number. MR. KANASTER agreed.

MR. PIHL noted that prior to the fiscal year 2014 valuation Buck was using the expanded payroll for both purposes. MR. KANASTER said that was a very important fix to the 2014 valuation.

COMMISSIONER FISHER asked if there was a piece of data that Buck was not getting that they needed. MR. KANASTER said he believed they were getting everything, and he just wanted to make sure that Mr. Pihl is satisfied.

CHAIR ERCHINGER commented that Mr. Pihl has brought up the payroll issue time and time again, and many people understood a piece of what he was saying but did not understand the full picture until Buck dug deeper into it last year and came up with the annualizing fix for determining the liability piece and using non-annualizing for the rate setting.

MR. PIHL made it clear that he expected things to work right between DRB and the actuary. Some board trustees are numbers people, but he did not want to micro-manage the relationships between DRB and Buck or the Department of Revenue and GRS. But trustees still have a role as the ARMB, and when they bring something to attention, it should be addressed. He said he had the 2014 payroll number, and he would like to see that number reconciled to Buck's starting number for PERS in their letter.

MR. KANASTER continued reviewing the last few items on the valuation timelines chart.

MR. KERSHNER stated that by the April 20th Actuarial Committee meeting Buck will have provided DRB with the draft valuation reports (from items 13-16), and then those reports will have already been sent to GRS around Christmas/middle of January. The plan is that by mid-April Buck will have received the observations and comments from GRS, provided their response, and be prepared to talk about all of those issues at the April 20th committee meeting.

MR. KANASTER said that he'd like to revive a past practice where any time a date was changed in the timeline a revised timeline was issued about every two weeks. Also, that the revised timeline get sent to everybody who needs it, so he assumed Buck should send the document to the board liaison, Ms. Hall, for distribution.

Deputy commissioner JOHN BOUCHER asked if DRB was ever a problem in terms of turnaround when reports were sent to the division from Buck for review. MR. BADER said yes, that many times there has been a substantial lag before DRB sends reports to Ms. Hall in Revenue to be forwarded to GRS. MR. BOUCHER noted that the Buck timeline indicates the time period December 18 to January 8 for DRB review, so he wanted there to be clear expectations when this period includes several holidays.

MR. TRIVETTE remarked that getting reports from point A to point B has been an issue, leaving the people at the end of the process very little time to read and absorb a lot of material.

MR. PIHL asked why the Buck reports could not go to DRB and GRS at the same time for a parallel review. MR. BOUCHER said he agreed on principle but would check on that. If the timeframe could be accelerated, the department was interested in doing that.

MR. BADER said he could see a benefit in having the Department of Administration look at Buck's work product before it is passed on. While the Department of Revenue seldom has comments on GRS's work, the department owns it at the time it passes it on and it is an important element. It needs to be a priority for DRB to pass Buck's reports on.

MR. KANASTER stated that he would be keeping an eye on the timeline this coming year so the chart states exactly who has responsibility for the valuation at any given time. MR. KERSHNER suggested adding a status column to the timeline. He added that Buck would bring the latest version of the timeline to each meeting.

2. **Specifics of Valuation Process for Alaska Retirement Systems:**
   a. **Data receipt and reconciliation**

MR. KANASTER said Buck is scheduled to receive data from DRB on September 1. Mr. Worley is trying to deliver the data a bit sooner, if possible. As a first step, Buck will review the data for reasonableness (age, retiree benefit amounts, or unexpected status change) and consistency (comparing the data with last year). Once the data set is good, Buck can send it on to GRS so they can start doing some concurrent work. Buck will then calculate the liabilities, check their own test lives, and multiple people verify them. Once they are convinced that the liabilities are correct, they can send test lives to GRS.

   b. **Report production**

GRS will be reviewing the test lives, while Buck puts together the reports. Buck also will be working on the projections at the same time.

   c. **Preparation of material for audit**

Buck prepares material for the auditing actuary to review, which they are talking about now.

   d. **Preparation of the new roll-forward contribution**

As with 2014, Buck will be calculating the new roll-forward contribution. The most recent change to the roll-forward was to assume a 0% population growth for those two years, so Buck did that for the contribution level that committee members will see later in the agenda. They now consider the roll-forward as part of the report generation process.

   e. **Process for changing assumptions**

Any time Buck is changing assumptions, everyone will know ahead of time. When Buck has all the necessary approval to change assumptions, they will document that in the back of any reports.

   f. **Preparation of materials for the board meeting**

Buck will summarize the valuations in a presentation, as Mr. Slishinsky has done in the past, and discuss any other issues that anyone wants to talk about.

MR. KERSHNER asked how long in advance Revenue needs the presentation material to distribute to everyone. MS. HALL explained that she sends out an email about a month before the board meeting that sets out the logistics for the meeting and informs presenters when she needs their material. It is usually 15-18 days before the meeting. The Board likes to have the material at least one week before the meetings.

B. Actuarial Audit

1. General Overview of Audit/Review Process

MS. THOMPSON said the timeline from Buck was awesome, and she was happy to hear there were even more possibilities to shorten the process. She said the meat of what GRS does is in the test lives. The reports for the valuation are not so meaty, because Buck tends not to change them. It is really in the numbers where GRS does its business.

2. Specifics of Audit Process for Alaska Retirement Systems:

a. Receipt of data and reports

MS. THOMPSON stated that GRS will be adding the pay audit to the data to get the reconciliation done, based on Mr. Pihl's findings last year. That is critical to the valuation.

She has found in the actuarial audit that trip-ups occur when factors in the process change. For example, there was a big delay at DRB when the assumptions were changing, such as the mortality assumptions. When the new roll-forward was instituted, she felt she was dealing with it at the last minute. Everyone has to pay more attention when there is change.

CHAIR ERCHINGER stated that when the legislature changes statute, clearly those changes are unavoidable. The departments and the actuaries will have to deal with those, and the timing is mandated. Related to actuarial assumptions, it seems that nothing really has to happen today because the changes affect the next 25 years, so it would be better to take a more deliberative approach to them. Why the recommendations to change assumptions that come out of the actuary's experience analysis have to roll into the current year seems to be part of the problem. Everyone scrambles to try to change the numbers at the last minute. Perhaps that part of the process should be a future discussion. She thought part of the Board's frustration last year was because there were so many changes happening, and the Board was not involved or even informed about them until after the fact.

MR. KANASTER acknowledged that last year was a very big year for assumption changes because it was the first year that Buck applied the pension experience study, which GRS reviewed. That was not typical and will not happen this year. This year the only assumptions that Buck might bring up to review are new per capitas and new trend rates.

MR. BOUCHER agreed that there were a lot of unusual pieces in motion last year that happened because of the legislation, and concurrently there was a significant change in the mortality approach that was going to be material.

COMMISSIONER FISHER said that, even with all of those factors, he agreed with the Chair questioning if there was any reason that all the changes had to be crammed into last year or could there be a more deliberative approach that involves a process of education. It could be the following year before the assumption changes get incorporated.

MS. THOMPSON said she has observed that there seems to be a divorce at Buck between the people responsible for pension and the people responsible for healthcare. Many of the issues that GRS was raising were on the healthcare assumptions, which were the ones that Buck kept changing every year without the ARMB's knowledge or consent. Buck was interpreting the statute that said the ARMB is required to review those every year, and so they were both reviewing and recommending changes. She did not think that was an unreasonable approach for an actuary to do, but it does not fit here. She thought there should be a review, a consideration, and then a change in the following year for healthcare as well.

MR. KANASTER indicated that he totally agreed with Ms. Thompson. It is standard to update health per capitas and trend rates every year, but there is absolutely no reason why Buck cannot go through the ARMB and have everybody on the same page as they are doing it.

CHAIR ERCHINGER remarked that the Alaska statute requiring the annual review of healthcare is a little different, and it is different than the non-health issues as well. She added that it is great that Buck has specialists in healthcare, and Ms. Bissett did a great job of explaining a lot of things at the last committee meeting.

MR. KERSHNER suggested that GRS come to either him or Mr. Kanaster with questions and, based on what the question or issue is, they will find the right person at Buck to address it.

b. Testing

MS. THOMPSON stated that GRS developed a report card concept for the ARMB, and they do this because Buck gives GRS very good test lives, some of the best in the industry.

c. Preparation of reports and materials for the board meeting

MS. THOMPSON thanked Mr. Bader and others who recognize that when GRS gets a report with only a week to review it, it is a hair-raising experience. She added that she is confident this situation will be improved with Mr. Kanaster's timeline.

MR. TRIVETTE cited the case last September when GRS did not even have the report on Buck's experience study to review but was expected to give her opinion. All she had was the slide presentation.

CHAIR ERCHINGER remarked that based on what the committee heard at the last meeting and today, it does not sound like the process is broken but that good communication is going to speed things along. She added that Buck has taken a lot of shots for not getting things done on time, not having reports on time, and not giving things to GRS, and she did not think that was a fair characterization. Buck has done the work, and for whatever reason, either they have not gotten data on time or the report was supposed to be passed along and it was not. She said she has learned that there are a lot of other moving parts that are not Buck's fault.

VIII.

A. Integrity of Actuarial Reporting Process and Controls

1. Discussion and resolution of teacher data issue uncovered in 2014

MR. KANASTER reported that it appears that many of the teachers get terminated in May. Buck gathers data on July 1, and then many of those terminated teachers are rehired in September.

MS. HARBO explained that untenured teachers get pink slips in May, and then they are rehired in the fall when a school district knows what its budget will be.

MR. KANASTER said the bottom line in the valuation process is Buck would see a reduced number of active teachers and a large number of terminated teachers. Buck now understands that many of these teachers get hired back. They have been working with Mr. Worley, and the quickest and easiest solution is that he will get a list of active participants in September or even October 1. Buck will not start the whole data process over again, but they will check if anybody is on that active list that they have marked as a terminated participant. If that is the case, Buck will move them back over to actives so they have a correct listing of active participants. It is one more step before finalizing the data.

MS. RYAN mentioned that the teacher units may be another source to give insight into whether there is going to be a large number of rehires. She said Fairbanks is 20 teachers short because of budget cuts, so now they are either hiring back or looking at new hires because they have the student enrollment that they need the teachers. MR. KANASTER said that he did not think Buck could use that in the valuation, but it is a good thing to know. MS. RYAN warned to be prepared for the numbers in the school district situations to not be as stable as they used to be for a while. MR. KERSHNER stated that there has to be a point at which the data that Buck is going to use is the data. So if this is in the tens and twenties of people, rather than hundreds of people, it might not be as big an issue if Buck does not capture those 20 that are finalized or hired in December until next year's valuation. MR. KANASTER said the current teacher fix is meant to get a better approximation as of July 1.

MS. THOMPSON stated that throughout the years GRS has talked about a persistent termination loss which she does not understand. There is a perpetual rehire loss in TRS, and she has talked to Mr. Slishinsky about this, who explained the way that Buck values rehires. As Buck does the true-up for teachers, she will be looking for the rehire loss to go away because they are not really rehires, if that was the issue. She wondered if Buck should look at if there are zero hours for two years in a row to see if a teacher is really gone, otherwise keep them on as active. However, it did not feel to her like the true-up with the teacher list in the fall was going to work either.

There was a brief discussion about whether a code in the data that identifies pink-slip people that may come back would allow Buck to make an assumption that 50% of them will come back. The problem is which ones to pick. MS. HARBO pointed out that DRB's membership data shows the PERS and TRS members who leave the system and leave their pension money in and may come back, and the members who leave and withdraw their money and are completely out.

MR. KANASTER said Buck's plan right now is to go with the October 1 payroll. They have a month to decide to do something different, such as taking 50% of the people who have a reduction-in-force code. He welcomed any ideas.

MR. BOUCHER commented that initially it seems that using the October payroll to compare to the May payroll is the best starting point to see what kind of adjustments show up from the change. He recommended trying that first.

2. **How is the accuracy of the underlying data ensured? For both pension and health care?**

MR. KERSHNER stated that there are two levels of data review. The level of review done by the actuary and reviewing actuary is a test of consistency compared to the prior year's data and the reasonableness of the data. Part of the review is the back-and-forth between the actuaries to address concerns about the data. A completely different level of review is the auditors (KPMG) looking at source data. Typically, the auditors will ask for the data that was sent to the actuary, and they ask the actuary for the data that was used in the valuation. Then the auditors also do their own research, for example, going to the source, such as a school district or other employer, to do their testing. That level of testing is not the responsibility of the actuary: there is no way the actuary can attest to the accuracy of the data that is given to them.

CHAIR ERCHINGER said the committee has talked before about the accuracy of the source data that DRB is getting from the employers; for example, the National Guard data and the healthcare data.

MR. PIHL stated that the Audit Committee has been dealing with the data issue in terms of the employer audit program. Also, KPMG is doing substantial additional work on the accuracy of employer reporting per the GASB requirements.

3. **How are the statutory requirements for audit met?**

MS. THOMPSON explained that this question was about the actuary doing their thing, GRS doing their audit and having findings, and then the findings have not been handled. That situation is now being handled by having this committee.

CHAIR ERCHINGER said it was a function of the Board as a whole addressing whether it had dropped the ball in doing the due diligence on the review actuary's work and follow-up on the recommendations from Buck and GRS.

4. **What will be the internal controls at Buck for ensuring accuracy of the valuation results and communications?**

MR. KERSHNER said Mr. Kanaster addressed that earlier. At Buck the data is checked and reviewed every step of the way through the valuation process. Mr. Kanaster, and Ms. Bissett on the healthcare side, constantly check everything in great detail. Then he (and formerly Mr. Slishinsky) has the responsibility to review everything again at an overview level. However, this year he got into the numbers in great detail because he has to understand the numbers to be able to talk about them. Once the checking and review process has been done, and before anything is communicated to either DRB or GRS, Buck has an independent review of the results and communications by someone who is completely outside the process to catch anything that may not look right. That central review includes reports, PowerPoint presentations, and communications of all types.

MR. PIHL asked if Buck had an independent auditor look at their process from time to time. MR. KERSHNER said that is what their central or independent review is aimed at.

CHAIR ERCHINGER asked if another actuarial firm does a peer review of Buck. MR. KERSHNER replied that he was not aware of that, but he knows there are actuarial firms that do hire an outside actuarial firm. CHAIR ERCHINGER remarked that the ARMB's review actuary process serves the same purpose, and maybe even to a greater level of detail.

The Chair called a 15-minute break at 10:30 a.m.

B. Integrity of the Actuarial Audit Process and Controls

1. How is the plan audited?

MS. THOMPSON stated that she considers what GRS does more of a review than an audit, because they do not do a full replication. GRS requests test life data, which shows them the "guts" of the valuation program, and they audit that. The results are used to prepare the report card at the back of each audit report. They also look at the overall data and audit the reports as well. More important is what is not audited, because it is not a full replication. GRS does not audit every data change. That is why the ARMB still needs a full-replication audit by another actuary every five years.

2. How are "test lives" chosen?

MS. THOMPSON used the example of last year when Buck changed assumptions and GRS requested test lives so they could monitor whether the assumptions were appropriately changed. Test lives are not random but are selected with an intention each year.

CHAIR ERCHINGER asked if GRS was selecting different test lives than Buck gives them, or if they were re-running the numbers on the specific test lives Buck gives them.

MS. THOMPSON clarified that GRS selects the test lives they request, otherwise Buck could cherry-pick the very good test lives, which would corrupt the audit process. GRS uses Excel and re-calculates from the beginning the normal cost of benefits, etc.

3. What is not audited?

Covered in 1.

4. What are the internal controls at GRS for ensuring the accuracy of the valuation audit results and communications?

MS. THOMPSON said GRS's internal controls sound identical to Buck. They have analysts who do the work, seniors who review all the work, consultants who review on top of that, and then a peer review that reviews documents and communications, etc. That is standard, whether it is valuations, special studies, or audits.

IX. Outstanding Discussion Items

A. Audit Issues for the Upcoming Valuation

CHAIR ERCHINGER stated that at the last meeting both Buck and GRS went through the chart of PERS/TRS/DCR audit findings to address the outstanding issues. Some issues that needed to be followed up were the result of the last experience study, and some issues were findings and recommendations from GRS. MS. HALL said she and Ms. Thompson worked on the list that was included in the meeting packet so that most of the items are for the 2015 valuation.

Starting with #1, Obtain Medicare and non-Medicare data, MS. THOMPSON said she has heard different stories about whether there is data or whether Buck is making an assumption of who has Medicare coverage or not. It is quite a significant assumption, in terms of impact on liabilities. Her proposed action for the 2015 valuation is to also submit the data to GRS so they can audit it. She has never seen that retiree medical plan data or the assumption or how it is applied.

MR. KANASTER said he felt this was resolved three or four years ago, and Buck has that data. There is a flag in the data to indicate whether a retiree is Medicare Part B only.

MS. HARBO mentioned that DRB has been refining the data every year, and at the May meeting Mr. Worley presented some actual numbers of people over 65.

MS. THOMPSON responded to the Chair, confirming that the missing piece is that GRS does not have the data.

On #2, Persistent loss in pension, GRS is monitoring.

On #3, Persistent gains in retiree medical, MS.THOMPSON said this was resolved because there was a discussion about the amount of margin at the last meeting. GRS will continue to monitor that and talk about it when they present their audit findings.

CHAIR ERCHINGER reminded everyone that healthcare margin was a topic the committee discussed with Ms. Bissett as a future possible education item.

On #4, Termination rates create losses every year, MS. THOMPSON said GRS would continue to monitor the termination rate assumption.

On #5, the “Other” category being a large number in Buck’s analysis of the changes in liabilities, MS. THOMPSON said GRS asked that Buck break it down further so people understand what Other is.

CHAIR ERCHINGER said she recalled that Mr. Slishinsky at the last meeting had indicated that two of the Other significant items were due to programming changes in the system and not specific to assumption changes.

MR. TRIVETTE suggested that Buck include an asterisk to explain when that happens.

On #6, Retiree medical - disability rates, MS. THOMPSON said she would have to check if this had been resolved. She felt the letter given to GRS did not resolve it to her satisfaction.

#7 and #8 were skipped, to be covered in the slide presentation.

On #9, Cadillac tax on retiree medical, MS. THOMPSON said she hoped Buck continued to agree with including evidence of testing for the Cadillac tax in the valuations. New regulations are coming out that add some specificity around determination of the Cadillac tax, however, there should be something other than just one person (being Ms. Bissett) saying that he/she looked at it.

On #10, Lack of external data on retiree medical, GRS has requested health claims data, and she did not remember the issues around why it was not available. She would like to see if the data or at least management summaries of the data can be transmitted to GRS so they can validate retiree medical valuations.

MS. THOMPSON said item #11 has been resolved (credibility weighting to most recent year on retiree medical).

On #12, Level of margin desired on retiree medical, she said the committee talked about it at a previous meeting, and there was nothing more to add.

On #13, Large TRS rehire losses, MS. THOMPSON said Buck may have solved the reason behind that. GRS will monitor it.

On #14, Present value of future salary used in determination of normal cost rate, she considered this the biggest issue the ARMB faced, and it was part of the slide presentation later in the agenda.

For the defined contribution plan (DCR), MS. THOMPSON said the committee has already discussed documentation of the retiree medical plan. Also, there was a change in the cost-sharing policy for healthcare premiums that made a significant impact on actuarial rates. GRS understood that it was all agreed to, but they needed a fuller description in the valuation for such a significant change.

On the National Guard, MS. THOMPSON stated that GRS believes there is some squishiness on eligibility service for who is in the Guard and what service counts. She has heard further that there might be a data issue there. She recommended that that get tightened up.

MS. THOMPSON referred to a short slide presentation on outstanding valuation issues *(on file at the ARMB office).* At the last meeting the committee asked her to prepare a slide presentation that highlighted an issue, Buck would respond, and then the committee would vote. She said Buck had fixed item #2 in the slide presentation a couple of years ago, although they had not indicated they changed it (healthcare participation assumption and retiree-paid premiums). GRS found it in the test lives recently.

MS. THOMPSON described the first outstanding issue. Early retirement factors are applied to a benefit when a person elects to go out before normal retirement, and they are used to reflect that a benefit amount will be received for a longer period of time. Buck's valuation averages a beginning-of-year benefit and an end-of-year benefit in that given year for that person's particular age. The impact of that is early retirement factors are being applied in some instances when there should be no early retirement factor, and it consistently understates liabilities. She described a PERS test case where Buck's early retirement factors were applied for the first year *(see slides for details)*. She said that instead of averaging beginning and end of year, GRS valued the benefit at the middle of the year. Buck's comment back to GRS was that it was minimal impact.

MR. KERSHNER explained that Buck uses a valuation system called ProVal that is one of the leading systems in the actuarial community. It is a standard system and very parameter driven, so Buck can tell it what to do specifically for a plan. This approach of taking the beginning of the year and the end of the year and getting an average is what is built into the system. Buck agrees, when looking at the individual example on the GRS slide, that the valuation system gets those results. But there can be a different combination where Buck's approach would actually result in a higher benefit. It is the rounding that GRS does where Buck would agree to disagree.

MR. KERSHNER gave another example using someone crossing over the 30 years of service threshold to get unreduced benefits. He said Buck does not believe someone who has 29.1 years of service at the valuation date and someone who has 29.9 years of service should be treated the same, which he thought would be the case if following the GRS approach. He said Buck's approach is consistent, and they believe the GRS approach of always rounding up means that they are always going to be biased toward one side. The methodology should not be chosen that results in a bias, either on the low side or high side. Having said all of that, Buck believes that regardless of which approach being talked about, the difference in the overall scheme of things is immaterial to the results. This issue only affects a very small subset of people who during the year of the valuation are crossing over into a service threshold period.

MR. KANASTER added that not only does it affect a small subset of people, it is talking about 85% versus 100% for one year of projected benefits times the decrement, which is in this case 6%.

MR. KERSHNER said they also did not believe in the statement in the presentation that says that Buck is consistently understating liabilities. Buck's methodology that is built into the valuation software is applied consistently, and they do not decide that in some cases they are going to round and in some cases they are not.

Responding to the Chair, MR. KERSHNER said he thought the issue would be a bigger issue and that their methodology was not appropriate if Buck only looked at the beginning of the year number and did not take into consideration that during the year the person is growing into an unreduced benefit. But they are factoring that in by taking the average of the beginning and end, as opposed to going to the middle and then rounding up.

MS. THOMPSON said that was a clear explanation and she enjoyed listening to it, and what Buck is doing is actuarially correct. But GRS believes that people do not decide in an actuarially rational manner, and that when somebody had 29.1 years of service they will wait to elect the benefits. The question is whether the ARMB wants this to reflect GRS's interpretation of reality or be actuarially correct. The decision either way is fine. She did not disagree that it probably is immaterial in the grand scheme of things. It could become material in the event of pricing a particular retirement benefit, and suddenly there are losses when more people do *this* when it was expected they would do *that*.

COMMISSIONER FISHER said Ms. Thompson's case showed that Buck's method understated the liability, and he asked her if it could also overstate the liability, depending on the case. MS. THOMPSON said no, that she thought Buck was always understating liabilities.

MR. BOUCHER wondered, if the ARMB adopted GRS's approach, if it is a material change to their software that is worth the extra work for this particular issue. He said he would like to hear about that at some point.

MR. KANASTER said he saw it as a change in assumption. Ms. Thompson is introducing an argument that somebody who has 29-plus years of service is going to hold off because of the early retirement factors, and that makes sense. Buck bases all of their assumptions from the experience study, so they are actually looking at the data when they come up with these rates. If Buck were to change to the GRS method, they would be adding one more assumption to retirement.

MR. KERSHNER said to make that change would be to ignore what the experience is telling them and use what they think is a more common sense approach, and he was not sure that was a precedent Buck wanted to establish. While they want to give the experience appropriate weighting and credibility, they cannot blindly look at experience. For example, there may have been no pay increases for four or five years, but it may not be indicative of the future because there have been some difficult economic times. It is an example of why they might adjust the experience. But the experience is the best source of information Buck has because that is what they are seeing for people who are within a year of retirement. That 6% and every other assumption that is used is the best estimate based on what the experience is telling them and what they think is the right assumption going forward.

MS. THOMPSON remarked that she did not know that Buck's experience study measured people who were one year away from their service date or if there was even a way to measure that behavior.

CHAIR ERCHINGER pointed out that the down turn in the stock market did cause people to delay retiring. She said Buck's argument is they are going by experience and people did not do what rational people normally would have done. She did not understand that.

MR. KANASTER agreed that the market turndown had people delay retirement, and he understood that GRS wanted Buck to then delay other people until they are unreduced.

MS. HARBO mentioned that healthcare is another important issue with the Alaska systems. People probably are going to delay retirement until they get system-paid healthcare. She thought someone with 29.1 years probably would work to the 30-year mark rather than pay $900 a month for healthcare.

MR. PIHL said the ARMB should be guided by reality, and the bias ought to be toward conservatism. His position was that if it was not a big fix in the computer program then the request ought to be to fix it.

COMMISSIONER FISHER said it would be helpful to hear why Buck thinks there is a distribution around reality and GRS believes it is always skewed.

MR. KERSHNER said Buck has set the assumptions based on the most recent experience analysis. That set of assumptions produces the expectation. He thought that GRS was suggesting to override what the experience is telling Buck for anyone who is within a year of retirement and to assume something different. The retirement rates are applied, whether a person is 24 years of service or 29 years of service, because that is what the data is telling Buck.

MR. KANASTER stated that if this discussion happened during the experience study Buck could look at that, or they could go back now and look at the old data. But they feel that their valuation looking at both sides and averaging them for that one year, for that one decrement, for that small group of people, is certainly actuarially sound.

MS. THOMPSON said she was not saying to go against what experience shows. She did not think the experience study was granular enough to show. She was saying that for that first year, when a person becomes eligible, to simply recognize that they are going to wait to retire.

MR. KANASTER asked her if she believed it was material to the valuation.

MS. THOMPSON replied that she trusted Buck's judgment on that.

CHAIR ERCHINGER stated that these were good debates to have, and it was also good to resolve the issue and move forward. She wanted to give Buck the sense they were following what they were comfortable with by using the experience and not diverting too much from their standard practice. She sensed a little discomfort in Buck using judgment, but she was on GRS's side in terms of humans generally acting rationally and what people were likely to choose. It would be great if everyone came to a decision that this is not material enough to ask Buck to make a change. If there is still disagreement that Buck's method consistently understates liabilities, the committee could instead ask Buck to put this on their list of things to look at in the future. It has been a great debate, and it gives an opportunity in the future to talk about to what extent, if any, judgment should enter into these decisions. She asked for the wishes of committee members.

MR. TRIVETTE said he was fine with leaving it the way it is right now but asking to try and get the data that will show what is really happening.

COMMISSIONER FISHER remarked that he was struggling a bit with the idea that the committee was going to spend a lot of time talking about things that people do not believe are material. He said maybe this is close to being material but he didn't know, and so he thought the committee should focus on issues that people think actually are going to move the needle.

CHAIR ERCHINGER said she generally agreed with him, but from a review actuary standpoint she thought the ARMB had not given GRS a charge to only bring items that are material. That would be to ignore more than 50% of the work that GRS does. The goal from the beginning has been to not ignore the work because it is all important. However, she agreed with the commissioner about not spending too much time on this.

CHAIR ERCHINGER suggested marking the early retirement factor item off the list as resolved and to continue with the status quo. In the future, if it becomes material, or more data comes forward from either side to say that the committee should revisit the issue, then the subject would be brought back.

MS. THOMPSON said the second outstanding valuation issue, the healthcare participation assumption, had to do with averaging as well, and Buck has already resolved it.

Item number three was the present value of future salary for determination of normal cost rate. She explained that the actuary revalues the normal cost of the retirement plan every year (the value of benefits accruing for the year). In that normal cost dollar amount are benefits like death and disability, termination, etc. To get the contribution rate, the normal cost is divided by the present value of future salaries. However, in the denominator for future salary there is no decrementing for those very things that are valued in the numerator (death, disability, termination, etc). The impact is that the denominator is bigger than GRS believes it should be, and that makes the normal cost lower than it should be. She said the numerator and the denominator should be valuing the same thing.

MS. THOMPSON referred to slide 29, which showed an example of a normal cost calculation comparison between Buck and GRS. GRS calculated the normal cost rate at 14.13% of pay, and Buck calculated it at 12.9% of pay. She did not believe the difference was immaterial. She said she had spoken to Mr. Slishinsky about it, and he had an opinion, but he was no longer here. She asked the Buck representatives if they had an opinion.

MR. KERSHNER stated that both approaches are reasonable, and, if the committee wanted Buck to adopt the GRS approach, they had no issue with doing that. The result will be an increase in normal cost, which, while the total contribution rate is over 22%, will fall to the state to pay. When the total contribution rate dips below the 22%, the GRS approach will shift more cost to the employers. Buck's position on this item is not as strong as it was on the first item.

MR. KANASTER clarified that this was not talking about liability measurement; this was talking about the funding method (the annual required contribution): how much money goes toward normal cost, and how much gets amortized under the AAL.

MR. KERSHNER said the GRS approach has more cost paid upfront in the normal cost component of the total contribution rate. Under Buck's approach, more is paid into the past service cost (the amount to make up the unfunded). It is not that one approach is necessarily always overstating or understating; it is just a difference of which bucket the approach puts the contribution in. And one approach puts the money in one year earlier, so it's a timing difference. Both are reasonable approaches.

MS. RYAN asked Ms. Thompson to go over the math of the GRS normal cost calculation again, which she did.

MR. KERSHNER explained that ultimately the goal is that sufficient assets are accumulated to the point where the last benefit dollar is paid. Either methodology gets the plan there.

MR. TRIVETTE said he found the GRS approach more technically accurate. Those are the kinds of things the committee should be considering. He did not think the additional cost to pay more now would be very high. If it could be calculated how much more it would cost to push the payment out over time and make future generations pay it, he thought it would be quite significant.

MR. KANASTER remarked that he would not argue with a client wanting to put more into the normal cost.

MR. PIHL commented that the ARMB has a statutory charge to see that the retirement plans are funded, and that is the answer.

MR. KANASTER asked if the committee wanted that change for the 2015 valuations.

CHAIR ERCHINGER said the committee cannot actually act and so is constrained in terms of the requirement to get approval at the full board level. Some things are being worked through with the state attorney and will be discussed further at the next board meeting.

MR. KANASTER said the September board meeting is not too late because Buck will be in the data process and will not have gone to the liability process yet.

CHAIR ERCHINGER offered her opinion that if Buck thinks the change in the normal cost calculation put forth by GRS is reasonable, and if Buck could also recommend it, then the committee would not be directing the actuary to do anything. It seemed reasonable to roll that change into the 2015 valuation, if there was no disagreement on the committee.

MR. KANASTER stated Buck's stance that both methods are good, so they would not argue against either approach. He intended to hold off any changes until September when this would be brought up again.

MR. KERSHNER said Buck was prepared to reflect the change in the 2015 valuation.

MR. BOUCHER said he had not heard from Buck whether or not this was a material issue. He had gotten from the committee's tone that the members felt this was a material issue. He wanted to hear Buck's opinion.

MR. KANASTER stated that the plan is going to be funded, that the ARC (annual required contribution) payment will be made, and the liabilities are going to be paid for. Whether the ARMB wants that to be paid now or later, Buck believes both methods of calculating the normal cost are good. As far as materiality is concerned, both are acceptable methods to pay this off.

CHAIR ERCHINGER commented that it was probably fair to say that, to the extent that more is not paid now, the employers and the state will pay a lot more later because of the delay in paying. She asked if it was fair to say the difference in approaches could become material.

MR, KANASTER said it is pushing the payments off later under interest, so he saw it as basically being the same.

COMMISSIONER FISHER remarked that he thought the legislature would regard this as material because it will impact the state budget. He did not disagree with the decision, but it will impact the state assistance payment in a material way.

MR. KERSHNER stated that Buck has not measured the impact of making a change in the calculation of normal cost. Referring to Mr. Boucher's earlier question about whether Buck thought the difference was material, he suggested that Buck go back and calculate the normal cost for the plan as a whole and have the results ready for the September board meeting.

CHAIR ERCHINGER mentioned that some committee members do not have to deal with the state budget and do not have to think about that, while those members who do have to deal with that have much bigger fish to fry. She noted that at its last meeting the committee made some decisions that changed the healthcare cost trend rate, which had a fairly significant reduction in employer contribution rates. The committee is trying to look at the issues purely and trying to do the right thing as it goes along. She thanked everyone for working together.

The Chair called a break for lunch at 11:50 a.m. The meeting resumed at 1:05 p.m.

B. Assumption Changes Proposed for the Upcoming Valuation

[Refer to August 10, 2015 letter to deputy commissioner John Boucher from Buck Consultants, included in the meeting packet and on file at the ARMB office.]

MR. BOUCHER said the State is under extreme budget pressure, and the administration is trying to accelerate getting information from the departments earlier than normal. Part of what the Department of Administration is looking at in the letter is to help get some placeholder numbers for the state assistance contribution for PERS, TRS and JRS for fiscal year 2017. Buck provided two scenarios: one with a two-year roll-forward of assets and liabilities, and one with a one-year roll-forward of assets and an estimated 3.3% investment return. That was the best information available at that time to give to budget planners. His view was that, for the purposes of planning, the second scenario (Exhibit B) more likely represented where the projected FY17 employer contribution and state assistance contribution would land. Obviously, things can change between now and the final budget.

MR. PIHL had a question on how the projected payroll base was developed and if it was off of actual payrolls. Also, the exhibit calculation shows a one-year impact, and he wanted to know what the impact is going forward to cover the $1.1 billion shortfall in earnings this year. He interpreted the letter to say that it was all based on percent of pay, which raised an alarm with him that it was back-loaded. He also wanted to know how the smoothing that has been developed works.

On the smoothing, MR. KERSHNER said the asset value was reset to the market value as of 6/30/14. Buck's understanding is that going forward they would still apply the same five-year smoothing that has been applied in the past, starting with the refreshed asset value. So the 6/30/15 asset value will have one year of smoothing, unless Buck is told otherwise.

MR. PIHL asked if Buck was going to use the real value at 6/30/15 or defer 80% of the investment loss that occurred in the last year.

MR. KERSHNER replied that they wanted to discuss that. He added that the committee and the board have to decide whether to use market value without any smoothing. That will lead to extreme volatility in contributions from year to year. If there is no asset smoothing, then the 6/30/15 asset value will be the market value. The unfunded amount that exists between that market value of assets and the entry age normal accrued liability will be amortized over 23 years.

MR. KANASTER added that using Buck's approximation of a 3.3% return, if they use market value for the 2015 valuations, they will take that loss (the difference between the 8.0% assumed return and the actual return estimated to be 3.3%) and recognize that completely in a single year.

MR. PIHL disagreed, saying that the loss would be amortized, which is a form of smoothing. That could be the interpretation of smoothing.

MR. KERSHNER said that in an actuarial sense one is how the plan is being funded and one is how the plan is being valued. How the plan is being valued is a comparison between liabilities and assets. The entry age normal cost method is used to value the liabilities, and then a separate decision is made on the asset valuation method. You can use market value or some sort of smoothing. Once the unfunded amount is determined, that difference is then funded over 23 years, in this case.

MR. PIHL said he could interpret the legislative intent to say stay with market value and update to market value at all times, and amortize it over the remaining years of the amortization period, which the legislature said was to be a new closed period of 25 years. It is not to delay recognizing 80% of the gain or loss on investments.

MR. KERSHNER commented that looking at all the state retirement systems across the country he doubted he could find many, if at all, that use straight market value, because of the volatility.

MR. PIHL responded that it did not matter, because the Alaska legislature said to go to market value as of 6/30/14, and they said eliminate smoothing. He believes that going to market value and that combination means what it means. Buck would be smoothing the gains and losses over the remaining period, in terms of the contributions coming in.

CHAIR ERCHINGER asked Buck, assuming a purely theoretical earnings of 2.0% this year, to explain the mechanics of how that investment loss (the difference between the 8.0% target and the 2.0% actual) would be smoothed over a five-year period or taken in a single year, and what that would look like.

MR. KERSHNER obliged, using the example that the market value of assets at 6/30/14 is $100, and the market value of assets as of 6/30/15 is $110 (some from earnings and some from contributions). Also assume that the entry age accrued liability at 6/30/15 is $150. Under method one, without any smoothing at all, Buck would take the difference between $150 and $110, meaning an unfunded liability of $40 is going to be amortized over 23 years and then added to the normal cost contribution and then the DCR to get the total contribution rate. Method two says restart the five-year smoothing effective 6/30/15 and going forward. If Buck expected that with the 8.0% return the assets would be $120 as of 6/3/15, they would recognize 20% of that $10 loss, or $2. The smoothed asset value in that case would be $118, instead of $110, because they are not recognizing… [incomplete sentence]. So now the smoothed value of assets is $118. Buck compares that to the $150 accrued liability, and instead of the unfunded being $40, the unfunded is only $32. Now that $32 is amortized over 23 years. But they will recognize another 20% of the loss per year over the next four years. That is the difference in approaches.

MR. KANASTER remarked that the whole point is the market crash in 2008; if the plans were to take that entire hit from 2008 in one year it would be death. Instead, Buck takes 20% of that loss over five years, and it provides more time to plan and recover.

MS. THOMPSON said that everyone understands smoothing but a couple of things are at issue. One is that even she was surprised that Buck came back with smoothing in the roll-forward when the legislation said no smoothing. She thought there was a decision at the last meeting to go to market on the roll-forward and there would be no more smoothing.

MR. KERSHNER agreed, saying that is what Buck reflected in the roll-forward. Today, he was talking about doing the 6/30/15 valuation, and it was Buck's understanding that they were going to continue with smoothing.

MS. THOMPSON asked him where he got that understanding. MR. KERSHNER said that was the understanding that Mr. Slishinsky communicated to them – to reinstate smoothing after the refresh to market value on 6/30/14. However, if the ARMB wants to go to market value, the consequence will be the volatility, and it will be very unusual to use market value.

CHAIR ERCHINGER agreed that that was what was done last year, and the Board did not weigh in on that issue until after it was a done deal.

MR. BOUCHER said his understanding is that Buck made the recommendation and the Board did not necessarily adopt it. He thought from the last Actuarial Committee meeting that the question was still open and not decided. CHAIR ERCHINGER indicated she agreed.

COMMISSIONER FISHER asked if anyone had looked seriously at the legislation, and did the ARMB have the flexibility to do something other than what is being done.

MR. BOUCHER remarked that he personally thought it was always difficult to read legislative intent, but he thought there was flexibility.

MR. PIHL stated that when the methodology was percent of pay and the payroll was growing from $2 billion to $7 billion over this time, the impact on the first year was really minimized by a huge payroll growth assumption that contributions were going to come in on.

MR. BADER commented that there is a whole lot of legislative intent that the administration may choose to ignore, and sometimes one has to pay for ignoring what the legislature said. In this instance, the legislature said to go to market value of assets. That means the legislature will be asked for several million dollars more money in additional state assistance. If the asset value is smoothed, that will not be necessary, at least not this year. The legislature might be more tolerant of ignoring their intent in that scenario.

MR. TRIVETTE read aloud sections in the senate committee substitute for HB119: "It is the intent of the legislature that ARMB and DOA direct the plans' actuaries to eliminate two-year rate-setting lag for PERS and TRS."…."It is the intent of the legislature that ARMB and DOA direct the actuaries to eliminate asset value smoothing from public employees retirement system and teachers retirement system actuarial valuations." He recalled that former board legal counsel Rob Johnson talked to the Board about this at the June 2014 meeting to explain what the intent language meant and did not mean. He cautioned that there can be backlash if an entity ignores legislative intent.

MR. KERSHNER confirmed for Mr. Pihl that the contributions in exhibits A and B are based on market value, without smoothing, because they are based on the 6/30/14 asset values. He said he had been referring to the 6/30/2015 valuation, which he understood that the 6/30/15 asset value would have the gradual phasing of the smoothing. There is no smoothing on the 3.3% estimated return.

CHAIR ERCHINGER remarked that first there was smoothing, then there was no smoothing in 2014, so it would be consistent to continue with not smoothing for the 2015 valuations.

MR. KERSHNER responded that it is not unusual, when using a five-year smoothing like the Alaska plans had, to reset it to market value at some point if the smoothed value is too far away from the market value – either on the high side or the low side – and then continue smoothing going forward. It is a refresh and then continuing with the same smoothing method being used all along.

COMMISSIONER FISHER shared his sense that with the legislature intent does not get the same level of scrutiny that other aspects of legislation does. His question was if it was inconceivable, both from an actuarial perspective and from a board perspective, to give the legislature two numbers and say that the ARMB had some question about what they meant by their intent, so here is one calculation that is smoothed in the following way and here is one that is not smoothed, so please clarify for us what you want.

MR. KANASTER replied that off-hand it sounded like a fairly easy tweak.

CHAIR ERCHINGER said her personal opinion was that a smoothing method should be used if that was the industry standard. Also, the legislature may or may not have intended what some people are interpreting. She agreed that if the legislature were given two rates, they would probably budget for the one that was the lesser of the two. So even if the ARMB agreed it wanted to go back to smoothing, but it gave the legislature both options and they picked the "not go back to smoothing" option, then everyone would have the answer to the question that there is no answer to today. That would help inform the ARMB on where to go from there. She said that as a fiduciary she wanted to get as much money into the system as possible and quit pushing stuff off into the future, which is why she favored the level dollar approach versus level percentage of pay. She supported Mr. Pihl that in a year when the investment return is lower than the expected return, it is too bad that the contribution rate cannot be increased because that would help get more money into the systems. It is a bit of a circular problem where the ARMB is trying to do what is actuarially right and also trying to figure out how to fund the system. Those two things are not always going to be headed in the same direction.

MR. BADER said the Board will have to determine a contribution rate at the September meeting, and they may want to supply the administration and the legislature with two different rates. The administration will attempt to build the budget based on the rate the Board approves because that is a statutory requirement.

MR. KERSHNER responded to the Chair's last comment, saying that the actuary follows the objectives of the ARMB to determine the funding. Then the actuarial calculations are done in the way that is consistent with the Board's objectives. Buck is not saying something should be done this way or that way; they do it whichever way the Board tells them to do it.

CHAIR ERCHINGER clarified what she meant: when the legislature codified what the ARMB would do, such as using level percentage of pay, they eliminated that tool from the Board's tool kit. The Board was going strongly down that path in the interest of trying to get more money into the systems upfront so interest earnings could fund the bulk of employer contributions down the road instead of employers having to fund those. Now, in trying to do strictly what is actuarially the right thing to do every year, it is continuing to push those costs off into the future, but not because of anything the actuary has done or any decision of the Board. By going back to smoothing, but doing it in a year of not achieving the expected investment returns, it is further pushing things off into the future and exacerbating the unfunded liability. That is contrary to what the ARMB has been focused on to try and close that gap.

MR. PIHL indicated he disagreed with the notion of going back to smoothing.

MR. KERSHNER stated that determination of the FY17 contributions is based on the assumptions and methods that were used for the 6/30/14 valuation, which was no smoothing. If the committee and board decided as of 6/30/15 to reintroduce smoothing, it does not affect the FY17 contributions at all.

CHAIR ERCHINGER asked by what date Buck needed a decision on whether to use smoothed asset values in calculating the valuations.

MR. KANASTER replied that it could be put off until the September meeting. It is not needed until the liabilities and data are done and Buck is putting the report together.

MR. BADER observed that the Board approved the contribution rates in September last year and it worked for the Office of Management and Budget.

CHAIR ERCHINGER said that decision is a big decision, and she felt the Board as a whole needed to weigh in on it. The committee could make a recommendation today to forward to the Board or wait until the September committee meeting and make a recommendation at that time.

MR. TRIVETTE said he preferred to take action today and not wait until the day before the September board meeting. He asked Ms. Thompson for her recommendation.

MS. THOMPSON said she did not have a recommendation.

COMMISSIONER FISHER said one of the reasons he thought smoothing was important to the fiduciary duty is that significant swings in the state contribution harm the ability to continue to give a consistent state funding. Wide swings in that number make it hard for the legislature to predict. He was concerned that a strong year of investment returns would drop the state assistance contribution number down a lot, and then a series of weak years would raise the state contribution quite a bit. As a fiduciary, he did not think it was an easy one-way answer that smoothing always helps the ARMB's fiduciary responsibility. He said he also agreed with others that he did not want to go on record as somehow saying he was ignoring legislative intent, but he believed that there are practical reasons for why the Board should consider that.

MR. PIHL pointed to large drops in state assistance amounts from higher numbers in the past, so all it would be doing is getting back to where the assistance payment was. In the final analysis, the legislature is going to fund what it is going to fund. The ARMB is just bringing to the legislature a fiduciary responsible approach to funding.

CHAIR ERCHINGER said that presenting both approaches seemed to be not getting sideways with the legislature, where the Board was trying to honor what it thought the legislature meant, but the legislature may not have understood the impact on volatility. She agreed with the commissioner that it will be near impossible to keep adding back to the budget. Lastly, she did think the committee would be any further ahead by delaying a decision on whether to smooth until September.

MR. TRIVETTE asked if the actuaries would make a recommendation on what committee members as fiduciaries should decide.

MR. KERSHNER said one thing not discussed yet is the new GASB 68 requirements, and they require the use of market value, which is not uncommon in the accounting field. In the private sector, the FASB also requires that because they are always looking for mark-to-market as a methodology. The GASB rules, which are so much of the FASB rules, in the sense of mark-to-market, now require the use of market value for purposes of the employers reporting on their financial statements. As an actuary, he cautioned that the consequence of going to market value with no smoothing is the volatility of contributions. If there is a concern about the volatility, then smoothing is a way to address that concern.

MS. THOMPSON said that what she was starting to hear is that in providing two rates the ARMB was giving a message of the actuarial best practice for the plans. Because the plans are closed, there is an actual horizon at which the plans need to be funded or it will be writing negative checks. The actuarial best practice around closed plans is level dollar for a variety of reasons, not legislative best practice or budget best practice. She wondered if the message should be wrapped around the issue of best practice and then the ARMB's best interpretation of legislation. That was her recommendation. She was not as nervous about smoothing or not smoothing in a closed plan as she was about level percent of pay. To her, the funding in the closed plans has to be accelerated because the horizon is upon us. She would quit smoothing when the horizon was about 10 years; right now the horizon is 23 years.

CHAIR ERCHINGER said she liked what Ms. Thompson said. She did not think the ARMB could recommend that rate of actuarial best practice to the legislature as Ms. Thompson defined it because it goes contrary to the statute (which is level percent of pay).

MS. THOMPSON related that in Illinois, which is the poster child for what not to do, they are very careful to provide a different message to the legislature, because the statute forbids decent funding.

COMMISSIONER FISHER stated that this was a sufficiently serious topic that the full board should take it up.

MR. KANASTER asked if the committee wanted a letter at the September board meeting that shows both smoothing and not smoothing, to help facilitate that discussion in front of the full board.

CHAIR ERCHINGER stated that she did not want to make the decision based on the numbers; she would like to make the decision based on the policy. She asked, however, how much effort it would take for Buck to run three sets of numbers: level percentage of pay with smoothing; level percentage of pay without smoothing; and level dollar with smoothing.

MR. KANASTER replied that taking away or adding the smoothing was not that big of a deal, and Buck could do that fairly quickly. Running a level dollar versus level percent of pay would be a bigger effort.

CHAIR ERCHINGER said she liked Ms. Thompson's comments about messaging because she thought that was what was getting lost in all of this. She did not feel that she was able to do the job as a fiduciary because she thought the ARMB was hamstrung by the statute. The ARMB has to honor the statute, but she still thought the message was important. Further, she agreed with the commissioner that the full board has to take up this question. The question today is whether this committee was going to make a recommendation to the full board or just open it up to the full board to have this whole conversation again.

Regarding timing, MS. THOMPSON remarked that she wished the ARMB could be making this decision when there were huge investment gains. She added that the state assistance contribution is very volatile because it is leveraged against the employers. She wondered if the ARMB should be making this decision when the state contribution is at high tide and, to avoid the volatility, suggest keeping the state's contribution at high tide. Or by doing it this way, with smoothing, is it moving the state contribution to a low tide and then becoming more hamstrung because the ARMB gave the legislature a low-tide number.

MR. PIHL stated that the August 10, 2015 letter from Buck deals with $1.2 billion in shortfall to be added to the unfunded liability. It states that without smoothing the additional state contribution would be a total of $78 million. He considered $78 million on $1.2 billion to be a substantial form of smoothing.

CHAIR ERCHINGER asked if committee members were prepared to each make a decision about whether to recommend smoothing or not smoothing. She preferred to make a recommendation to the Board to at least reduce the duration of the dialogue at the board level.

MS. THOMPSON asked the committee if they meant 5-year smoothing when referring to smoothing. She said five years is the most common, but some plans use three years.

MR. KERSHNER guessed that probably 75% of the plans that use smoothing use five years.

<u>MR. PIHL moved that the Actuarial Committee recommend to the full Board to eliminate smoothing by using market value in the actuarial valuations</u>.

COMMISSIONER FISHER said he was willing to second the motion if there was an understanding that the ARMB would provide the legislature with two numbers, one without smoothing, which is the Board's recommended number based on how the Board understands the legislative intent, and a second number which is with smoothing. The committee would inform the Board that the second number is based on what the committee understands to be best practices. If the motion was to give the legislature only the unsmoothed calculation, then he would prefer not to have a vote now so he could study it a bit more.

MS. HALL indicated that that was getting into two topics in the motion. The Chair said it muddied the waters a bit, and she would like to have a motion that recommended X or Y, and then take up the issue of whether or not to provide both sets of information after that.

The motion died for lack of a second.

<u>MS. HARBO moved that the Actuarial Committee recommend to the full Board to continue to use five-year smoothing using market value of assets</u>. <u>MS. RYAN seconded</u>.

MR. KANASTER asked if that meant to start smoothing as of 7/1/15 again and use the actuarial value of assets then for the valuation.

MR. KERSHNER clarified that the smoothed value is what Buck calls the actuarial value, so the actuarial value is either market value or some smoothed value (and the smoothed value is determined based on market).

The Chair restated the motion for clarification: …that the Actuarial Committee recommend to the full Board to return to five-year smoothing beginning July 1, 2015.

MS. RYAN said she wanted to make sure that the committee has clear instructions to give both those numbers to the legislature. She wanted to follow legislative direction and not to be out of legislative intent. The motion was what most of the committee wanted to bring to the full Board, but if it is totally against the wishes of the legislature, then the Board would need to regroup in September.

MS. HARBO stated that was her intention, that the Board would give that information, as the commissioner said earlier.

MR. KERSHNER asked, if the committee voted to adopt smoothing beginning with the 6/30/15 valuation, if the direction was for the FY17 contributions to be recalculated for the September meeting using that smoothed value. Currently, it is based on market value with no smoothing. The roll-forward takes the 6/30/14 assets, which was market value, and rolls it forward to 6/30/16. In Exhibit B, which he thought everyone agreed is the preferred approach, that roll-forward for the first year used 3.3% and the second year used 8.0%. If there is no smoothing, which the exhibit reflects, it produces one set of FY17 contributions. If the decision is to use smoothing, then the rolled-forward 6/30/16 asset value will be higher than what Buck has reflected in the exhibit, because it will not reflect the full loss in FY15.

MR. KERSHNER said the alternative is that the FY17 calculation is not redone at all, and the decision to use smoothing starts with the 6/30/15 valuation, which is then going to be used to set the FY18 contribution.

CHAIR ERCHINGER said she thought the motion was for the latter.

MR. KERSHNER stated that the 6/30/15 asset valuation is not reflected in the exhibit: it is based on the 6/30/14. So adoption of smoothing, if that is the decision and recommendation, determines the asset value of 6/30/15.

COMMISSIONER FISHER observed that the exhibit included 2014 with an assumed return of 3.3% but no smoothing. So it, in effect, has an estimate of the investment return loss, and it is fully recognized with no smoothing.

MR. KERSHNER said Buck could do the same thing with the roll-forward and take the loss, but the projected asset value as of 6/30/16 could apply smoothing so as not to take that full FY15 loss immediately into these contributions. That is a different approach to what Buck presented in the letter, and that is different than starting smoothing with the 6/30/15 valuation.

COMMISSIONER FISHER said the ARMB should be consistent from the 6/30/14 asset value, to either apply smoothing from that date or not apply smoothing from that date.

MR. KERSHNER stated that Buck completed the 60/30/14 valuation using market value.

COMMISSIONER FISHER said he did not want to treat FY15 one way and then FY16 another way. It should be consistent from when it was taken back to market value.

MR. KERSHNER said that so far Buck has rolled forward with no smoothing. COMMISSIONER FISHER said the motion was to roll it forward with smoothing.

MR. KERSHNER said it was no problem for Buck to do that. However, that is different than restarting the smoothing with the 6/30/15 valuation because that does not affect not applying smoothing to the roll-forward. There is a subtle difference.

MR. KERSHNER suggested some wording if the committee wanted to incorporate smoothing into the calculation. The motion would be – <u>recommend that the 6/30/14 valuation be performed using market value, and from that point forward adopt five-year smoothing</u>. Then the roll-forward would change.

CHAIR ERCHINGER asked the maker and second if that reflected the intention of the motion. MS. HARBO and MS. RYAN indicated they were fine with it.

MR. PIHL said he would vote against the motion because it did not follow what he believes is legislative intent. He believes the better approach is to follow legislative intent and eliminate smoothing, and also give the legislature the other number.

COMMISSIONER FISHER stated that even though he was not certain it was the right thing to do, the clearest interpretation of the legislative intent led him to support Mr. Pihl's reasoning.

MR. TRIVETTE said he totally supported giving both sets of numbers to the legislature, but he thought the committee and the Board had to make a decision to set the contribution rate in September. As an aside, he said he has been unhappy for years that the ARMB has not done a very effective job in communicating with the legislature. The legislature passed the legislation 15 months ago, and the ARMB has not written them anything about what they enacted. That is a failure on the Board's part. The Legislative Committee or the full Board needs to begin communicating more with the legislature.

<u>Roll call vote</u>:
Ayes: Trivette, Ryan, Harbo, Erchinger
Nays: Pihl, Fisher

The motion passed, 4-2.

CHAIR ERCHINGER opened the floor to any additional motions relative to the additional information to bring forward for the legislature.

<u>COMMISSIONER FISHER moved that the Actuarial Committee recommend to the full Board to</u>

supplement the recommended contribution rate with a calculation performed with no smoothing. MS. HARBO seconded.

On a roll call vote, the motion passed unanimously, 6-0.

MR. KERSHNER asked, when Buck redoes the calculation with smoothing for the September meeting, if they should ignore Exhibit A (the 8% for two years) and only re-do Exhibit B with smoothing. Everyone indicated that was the committee's intention.

CHAIR ERCHINGER requested a cost quote from Buck to provide a comparison using level dollar and smoothing of asset values. She said as a fiduciary, if she was recommending to the legislature what the state should be paying, she would also be recommending using level dollar smoothed.

CHAIR ERCHINGER asked if Buck had any other proposed assumptions changes for the upcoming valuation that the committee should discuss.

There was mention of healthcare claims costs and the trend rates. MR. KERSHNER said Buck did not have any other recommended changes and were not aware of any that were needed.

Responding to Ms. Thompson, MR. KERSHNER said he would check with Ms. Bissett, who develops the healthcare assumptions, to see if the changes would be available in time to present at the September meeting.

CHAIR ERCHINGER reminded the Buck representatives that the committee had requested previously to look at the healthcare assumption changes by themselves, the magnitude of the changes, and the justification for the changes. This would help give the committee enough information to understand what they are looking at.

C. Content, Methods and Assumptions of the June 30, 2015 Actuarial Valuations and Audit

CHAIR ERCHINGER stated that much of this agenda item had been discussed earlier. She added that it will be interesting to see if GASB 68 changes anything in the future.

X.

A. Review and Approval of Valuation and Audit Timeline

This item was discussed earlier.

B. Methods for "Early Warning" if Deadlines are Slipping

MS. HALL said this was an item for GRS in terms of an early warning if a deadline slips. The other issue is what would be GRS's drop-dead timeline. For last valuation, Ms. Thompson's report was pulled off the April meeting agenda because she did not have enough time to do her review, and the Board did not see it until the June meeting. She said Ms. Thompson could let her know a date so staff could build it into the schedule.

MR. KANASTER stated that he and the board liaison would be talking a lot more regarding the timelines, so it there was a delay, everyone would know immediately in the timeline.

CHAIR ERCHINGER said she preferred that the committee not be involved in any of that, unless delays were going to affect the committee's work.

XI. Communication, Reporting Protocols and Formats

A. Presentation Materials at the Committee and Board Level

CHAIR ERCHINGER presented her perspective that the idea is to try to summarize the work of the committee for the full Board, to the degree possible, while not excluding the full Board from substantive conversations. She asked if committee members had a preference for the format they would like to see or if they would simply like to see board presentations be concise and informative.

COMMISSIONER FISHER remarked that many of the issues that the committee deals with can be represented as a consensus. His expectation is that the Board would accept that if there is no disagreement in the committee. When there are issues where there are some meaningful disagreements and clearly no consensus then he suggested that those issues get aired out fairly broadly in front of the Board.

CHAIR ERCHINGER proposed that presentation materials for both packets include information for the full Board so trustees can read them but not necessarily go through the presentations again at the Board level.

Regarding the outstanding valuation issues from the review actuary, MR. KANASTER asked if GRS would be finalizing the slide presentation without #2, application of the healthcare participation assumption, because that issue was settled two years ago. MS. THOMPSON said sure. MS. HALL said she has notes on each item, plus the recording of the meeting, so that presentation will be updated, and the Board will get the updated version.

CHAIR ERCHINGER said if she had the draft minutes of this meeting in advance of the board meeting she would go over what was voted on at this meeting and summarize it at the committee report level.

Citing the committee vote earlier to adopt five-year smoothing going forward that was not unanimous, MR. BADER related that when he was a trustee on the previous board he resented actions coming from a committee as a fait accompli. He asked how the committee wanted to allot time for such topics at the board meeting, because it relates to how he and Ms. Hall set up the agenda. He felt the topic of whether to adopt smoothing took a lot of time for people to understand the issue and all the implications.

CHAIR ERCHINGER said she thought there needed to be an opportunity to fully vet the issue, because it could go the other direction at the board level. The committee's job is to make a recommendation to the Board, but the Board has the right to do what it wants and needs time to deliberate, especially when the committee's action was not unanimous. She suggested 30 minutes on the agenda.

Responding to Ms. Thompson about whether she should be prepared to give a one-minute summary at the board meeting of her 10-minute presentation to the committee, CHAIR ERCHINGER stated her preference to simply summarize it as part of her committee report. She added that she thought the full Board needed to hear the substantive presentation of the valuations when they come out and the substantive presentation of the review actuary's final report.

MR. BOUCHER wondered if the Board would need any of the previous materials that the committee looked at over the summer, such as certain graphs. He did not need an answer right away, but he did not want to come to the meeting empty handed when some material might be needed as a refresher.

MR. TRIVETTE observed that the Board has spent a lot of time with the actuaries over the years talking about assumptions, including smoothing. He thought there were only two or three trustees who might have been present for part of those discussions, so it would be good to have some of that material to distribute. Regarding best practices, he thought the Board needed to talk about that.

CHAIR ERCHINGER stated that if there is any best practices material that shows what the best practice is for smoothing or not smoothing in a closed system, it would be helpful to have in the packet, as well as a copy of the legislative language. It serves as a record that the ARMB had access to that information and used it to come to its conclusions.

B. Actuarial Assumption or Method Changes Required for the June 30, 2015 Valuations

Covered earlier.

C. Any Findings of Actuarial Concern

Nothing to add.

XII. Future Meetings

A. Calendar Review

[The Actuarial Committee calendar from now until June 30, 2016 was included in the meeting packet and is on file at the ARMB office.]

CHAIR ERCHINGER pointed out that a major goal in the committee calendar is to move the per-valuation entrance conference up to June 22, 2016, instead of the end of summer like this year.

B. Agenda Items

At the September 23 meeting the committee will vote on the contribution rates and make a recommendation to the full Board, which will hopefully expedite the discussion at the board meeting. A review of the charter will also hopefully take place at the September meeting and perhaps a recommendation to the Board. Board legal counsel Stuart Goering is still reviewing some of the subsequent conversations that she and Commissioner Fisher have had regarding actuarial assumptions and the provision in the charter dealing with the committee having the opportunity to meet with the actuaries in the absence of administration.

MR. KANASTER added that discussion of level dollar was put off until the September meeting as well.

MR. KERSHNER responded to Mr. Trivette that Buck could provide a cost estimate to run level dollar with smoothing calculations next week, and the committee could give direction if it wanted that information for the September meeting.

MR. PIHL reminded everyone of the requirement to go through the board chair with all requests for services from the actuary.

CHAIR ERCHINGER asked Buck to provide the cost information to Mr. Boucher and Ms. Hall, after which the committee could decide whether to make that request to the board chair. Otherwise, the committee could at least discuss it at the September meeting.

C. Requests/Follow-Up

MS. RYAN asked if there would be a future discussion on best practices for closed plans. MR. KANASTER said that when Buck came up with a letter they would provide some thoughts on that.

CHAIR ERCHINGER suggested messaging as a future topic, as described by Ms. Thompson earlier today.

ADJOURNMENT

The meeting adjourned at 2:45 p.m., on a motion made by Mr. Trivette and seconded by Ms. Ryan.

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.

Confidential Office Services
Karen Pearce Brown