State of Alaska
ALASKA RETIREMENT MANAGEMENT BOARD
ACTUARIAL COMMITTEE MEETING

Hammond Room – Centennial Hall
101 Egan Drive
Juneau, Alaska

February 17, 2016

ATTENDANCE

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

Committee Absent: Tom Brice

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)
Kevin Worley (chief financial officer, Department of Retirement & Benefits)

Others Present:
David Kershner (Buck Consultants, actuary) *on-line*
Todd Kanaster (Buck Consultants, actuary) *on-line*
Larry Langer (Buck Consultants, actuary) *on-line*
Melissa Bissett (Buck Consultants, actuary) *on-line*
Leslie Thompson (Gabriel Roeder Smith, review actuary) *on-line*

I. CALL TO ORDER
CHAIR ERCHINGER called the meeting to order at 1:30 p.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

CHAIR ERCHINGER added item VII.E, Recommendations to the full Board (to ratify actions previously taken by the committee at the August 14 and September 23, 2015 meetings).

MR. PIHL requested that the discussion on allocation of the fiscal year 2017 state assistance be expanded to review allocations of all the funding to the system in the actuarial report.

Without objection, the agenda was approved as amended.

V. PUBLIC/MEMBER PARTICIPATION, COMMUNICATIONS AND APPEARANCES

No one present or listening on-line responded to the Chair's invitation to address the committee. MS. HALL said there were no communications.

VI. APPROVAL OF MINUTES – September 23, 2015

MS. RYAN moved to approve the minutes of the September 23, 2015 meeting and MS. HARBO seconded. There were no changes, and the minutes were approved.

VII.

A. Valuation Timeline Update

LARRY LANGER, the new lead on the Buck Consultants team for Alaska, gave a brief snapshot of his background as an actuary. He referred to the one-page timeline for valuations as of June 30, 2015, included in the meeting packet, and noted it was somewhat of a tight timeframe. The primary deliverable of the draft defined benefit plan reports went out as planned on December 18. However, the schedule slipped on getting the draft defined contribution plan reports to the Division of Retirement & Benefits: those were delivered January 20, 2016, instead of January 11. Buck intended to work better to hit those timelines in the future.

CHAIR ERCHINGER stated that the ARMB has a statutory requirement to wait to review the full valuation report until after the review actuary has seen the full report. She suggested talking at a later date about what that means. It seemed if there was a way to shorten the timeline it would be within the statute itself.

CHAIR ERCHINGER mentioned that some people had expected to see the draft valuation reports at this meeting. But according to Buck's timeline, the committee will see the draft reports in April and have an opportunity to weigh in at that time. The Board will set the final contribution rates at the June meeting.

1. Key Takeaways from FY2015 Valuations

MR. LANGER provided the highlights of the valuations that will be coming out. Buck is working through the review process with Gabriel Roeder Smith (GRS), the reviewing actuary.

He said he applauded the review process. There are many elements to a valuation report, and it is good practice to have a review actuary kick the tires on what Buck does. It gives everyone more assurance that the numbers in the valuation are doing their job. He has worked through this process with other large statewide plans, and he often thinks they get a better product as a result.

MR. LANGER stated that an actuarial valuation is done each year because the valuations are based upon estimates of a lot of activities within a pension plan to try to predict what type of benefits will be paid over the long haul and to estimate what type of contributions should go into these plans. Every year the actuary replaces the assumptions they anticipated would happen in the prior year's valuation with what actually happened. So, events happened during the past year that Buck did not necessarily anticipate. That is neither good nor bad: some of the events had a significant impact on the valuation and others had less impact.

The big significant impact in fiscal year 2015 was a large state assistance contribution to both the Public Employees' Retirement System (PERS) and the Teachers' Retirement System (TRS). That large state contribution impacted the funded ratio of the plans (how much assets are available to cover the liabilities of the plan). Buck had already factored that large state assistance into the contribution rates, so there will not be quite as steep a reduction in the contribution rates.

Less significant impacts (in the tens of millions of dollars) were:

- The fiscal year investment return, which is usually a big driver of valuation results, was somewhere around 3% for FY2015, instead of the assumed return of 8.0%. It did not have a big impact on this year's valuation results because those investment results are smoothed over a five-year period.
- Salary increases were less than anticipated. That means the projection of benefits is less, and so the contributions to the plan are lowered, and the funded ratio is increased.
- Post Retirement Pension Adjustments (PRPA) are less than expected.
- There were more deaths than expected, which translates into less money needed in the plan.
- The Retiree Medical Plan has had a marked increase in the funded ratio in the past few years. Much of that has been driven by the medical claims experience, which has been lower than what Buck was projecting.
- Other valuation process refinements from the back-and-forth with GRS resulted in benefit provisions that Buck could value better.

MR. LANGER said that, when compared to last year's valuation results, the impact of the above list resulted in a higher plan funded ratio as of June 30, 2015, and a lower employer/state contribution rate. Buck had already baked the additional state assistance amount into the FY2017 contribution rates, but almost all of the decrease in contribution rates can be attributed to the much-lower-than-anticipated retiree medical claims. He noted that the previous year's funded ratio did not include the impact of the additional state assistance contributions, which was the primary cause of the significant increase in funded ratio.

CHAIR ERCHINGER said the way the state assistance is allocated between pension and healthcare impacts the funded ratio of healthcare as well. She asked for clarification of his last statement.

MR. LANGER said that the lower contribution rate from FY2017 to FY2018 is almost all due to the healthcare experience during that year. When Buck developed the contributions for FY2017, they baked in what they knew was going to happen, which included primarily the extra state assistance money that has already been allocated between pension and healthcare based on the actuarial needs of the systems. Buck allocates the contribution numbers based upon the relative unfunded liability of pension versus healthcare.

At MR. PIHL's request, MR. LANGER further explained the process Buck uses to allocate between the pension fund and the healthcare in the PERS and TRS plans. Buck knows how much assets are in the pension side and the healthcare side of the fund. They calculate the accrued liability, which represents ideally the amount of money Buck would like to see in the fund as of the valuation date. The difference, or unfunded liability, is amortized over 22 years for the fiscal year ended 2018. The contribution rate for pension and the contribution rate for healthcare are based upon how much unfunded liability there is within the plan.

CHAIR ERCHINGER said it was a bit misleading to say that the increase in the funded ratio is mostly a result of the retiree medical claims experience. She thought a large part of it is also due to the state assistance allocation.

MR. LANGER said that the funded ratio improved markedly, primarily due to the additional state assistance contribution that was made during the fiscal year ended 2015, and it was helped along by the medical claims in healthcare being lower. Much of the improvement in the funded ratio at June 30, 2015 is a combination of those two items.

MR. LANGER said the decrease in the contribution rate from FY2017 to FY2018 is primarily due to the retiree medical claims experience, because Buck had already baked the extra state assistance contribution into development of the FY2017 contribution.

MS. HARBO stated that the medical claims experience is lower because most of the retirees in the closed PERS and TRS plans are now over 65 and are covered under Medicare. She thought the medical claims number would keep going down because Medicare becomes primary for most retirees at 65 and the state-provided coverage becomes secondary. It does not mean that retirees are going to the doctor less.

MR. LANGER said that was a good thing to think about. Buck's valuation process collects information on all the participants in the plans so that when they project forward what type of benefits will be paid they can factor in when individual retirees will hit age 65 and there will be a reduction in the medical claims for an individual. In a closed plan, they do see a drop in the benefit payments on the healthcare side.

MS. HARBO said she thought the statistic was 70% of the retirees in the closed plan were 65 or older.

MR. PIHL referred to page 24 of the 2014 PERS valuation report in which the allocations of the contributions coming into the system are shown. He read "the employee, employer, and state relief contributions have no relationship to the beginning unfunded liability." He said that starting in 2008 healthcare was two-thirds of the liability. As a result of these allocations over a number of years, the healthcare share of the liability is now only 17%, and the pension portion is 83%. That is way out of whack in relationship to the unfunded liability balance, the normal cost occurring, or the accrued liability balances. As a result, the unfunded liability left in pensions when it came to last year's allocation for GASB is $5.2 billion of the total. If the allocation were based on something closer to the unfunded liability or the other factors, the pension liability to allocate would have been $1.5 billion to $2.0 billion less. In other words, there would have been more liability in healthcare and less in pension.

MR. PIHL asked if Buck or the Department of Administration made the allocations to employee, employer, and state relief that he referred to in the 2014 valuation report.

MR. LANGER responded that in terms of the primary allocations, when talking about development of the contributions that go to the four separate plans (PERS defined benefit and defined contribution, and TRS defined benefit and defined contribution), Buck develops those allocations.

MR. KERSHNER of Buck Consultants said that page 23 that Mr. Pihl was referring to was what was actually contributed to each plan during the year. Buck does not determine the actual amounts. Buck determines the amounts to be allocated, and then the actual contributions are made as shown on that page.

MR. PIHL rephrased his question, saying that the contribution in that year was $312 million. In the actuarial valuation report it was allocated $176 million to pension and $135 million to healthcare. He asked who determined that allocation and what criteria it was based upon, because it has no relationship to the unfunded liability.

MR. KERSHNER replied that there are a couple of things going on. The contributions for FY14 would have been based on the 6/30/2011 actuarial valuation at that time, using the two-year roll-forward (although the roll-forward may have been implemented later). Buck determines the amounts to contribute to each plan based on the relative unfunded liability in pension/healthcare. The amounts shown on page 23 (of the 2014 valuation report) are the actual amounts that went into the pension trust and the actual amounts that went into the healthcare trust. Buck did not allocate $176 million out of the $312 million to pension – that was what was actually contributed.

MR. KERSHNER further explained that Buck determines contribution rates as a percentage of payroll. While he was not sure how those are actually tracked and allocated, they are based upon contribution rates that Buck determines.

MR. PIHL said he wanted to point out that over a period of years the ratio of unfunded liability has gone from 60% healthcare and 40% pension to 17% healthcare and 83% pension. It results in numbers that have no relationship to the real unfunded liabilities. And it had a dramatic impact on the allocation of pension unfunded liability that had to be made under GASB. The pension liability was higher than it should be by $1.5 billion to $2 billion. Therefore, the State of Alaska has reported half of that as being PERS and the other half as belonging to the other plan employers around the state.

MR. LANGER stated that when Buck puts forth the allocation it is based upon the unfunded liability at the time that Buck developed the contribution rates. There is a lag in the timing. Regarding the disparity that Mr. Pihl pointed out, healthcare going from 60% of the unfunded liability down to 17%, he did not think the allocation of the contribution amounts was a heavy driver toward that. The heavy driver over the past several years is the medical claims that have been coming out of the fund have been consistently less, and by a fair amount, compared to what Buck was projecting to come out of the fund.

MR. PIHL reasoned that, if the medical claims on the healthcare side are lower, then fewer contributions to healthcare are needed, not more.

MR. LANGER agreed that was correct, saying that Buck does lower the contributions to the healthcare plan in favor of the pension plan, as the claims experience comes out.

COMMISSIONER FISHER said that Buck was saying the healthcare expenses are changing as compared to expectations. Buck then made an adjustment, but the trend continued in the subsequent year. One could suggest that the department and Buck, between them, have done a poor job in forecasting those healthcare cost trends. But Buck is saying they have not skewed the allocation of contributions in favor of healthcare; they have followed the methodology and amortized it based on the unfunded liability at that time, based on the projections at that time.

Deputy commissioner JOHN BOUCHER agreed with the substance of the commissioner's statement. He said, to his knowledge, the Department of Administration has never suggested an allocation between pension and healthcare. It was during the large state deposit to PERS and TRS that they started seeing the trend emerging where healthcare seemed to be less as a portion of the overall unfunded liability and, on the other hand, the pension liability portion was growing. This was discussed at the board level, and his recollection is that Buck's David Slishinsky suggested that 100% of the large state assistance payment for PERS go to pension. He thought it was something like two-thirds of the $2 billion to TRS. He stated that Mr. Pihl's point is that if everyone had known about the healthcare cost trend at the time the large state assistance allocations were made between pension and healthcare, it might have been allocated differently. Currently, under the GASB rules, only the pension liability is being allocated among the plan employers. This is a temporary situation until the requirement becomes effective in about two years to allocate the full unfunded pension and healthcare liability among the employers. The point he was getting from Mr. Pihl is that because the department and Buck missed this by a significant amount, more unfunded pension liability was allocated to the municipalities than might have been otherwise, had the full information been available at the time.

MR. PIHL clarified that he was addressing the development up to 2014, where the ratio went from 60% pension and 40% healthcare to 83%/17%. He said the driver of that is how the allocations of the contributions coming in have been made over time.

CHAIR ERCHINGER remarked that that was getting to the bottom of the questions everyone has been asking. She suggested asking Buck to look at this specific question for the next meeting.

CHAIR ERCHINGER addressed Mr. Langer regarding her earlier question about the healthcare claims experience being the biggest driver in the change in the contribution rate. She wanted to look at what degree it is healthcare experience and what degree it is the allocation. It seemed that what was done in the past is done. She agreed with Mr. Pihl that the way it is now, in large part, is because of how the contribution allocations were done. The situation brings up the question of what this committee should do and what role, if any, it should play in looking at how the allocations happen in the future. Until seeing Mr. Pihl's calculations, she had thought the contribution allocations were made based on the proportionate share of unfunded liability related to pension and healthcare. Looking at the numbers, however, that does not seem to be the case. Buck is saying it is the case. The committee would like that clarified, and she asked Buck to add that to the list of items to discuss at the next meeting. Mr. Pihl could provide his analysis for Buck to review as well.

MR. LANGER said it would be good to reconcile those numbers, and looking at the analysis of others can give him insights.

CHAIR ERCHINGER thanked Mr. Pihl for bringing up the topic because it has been an overlooked area.

MR. LANGER continued with the Buck presentation, addressed the draft "Preliminary Key Observations from FY 2015 Valuations" (*slides 6 and 7*). The first was a comparison of the funded status of the PERS and TRS funds for FY2014 and FY2015 broken down in several ways. He noted that the funded status of the defined benefit pension side rose from 60% to 67% for PERS, and increased from 55% to 77% for TRS. Much of the driver on the pension side was the additional state assistance contribution. It is a different story on the healthcare side, where Buck had expected the actuarial accrued liability to increase from FY2014 to FY2015. But because of the healthcare claims experience that was 8-9% lower than projections, there was a marked decrease in the liability amounts. This was a continuation of a trend that Buck has been seeing. So there were nice increases in the funded ratios for the defined benefit plans. The PERS and TRS defined contribution (DCR) plans are newer plans and only cover health and the occupational death & disability benefits, so the liabilities are much smaller. The medical claims experience was a similar driver within the DCR plans as well.

CHAIR ERCHINGER asked what to expect when the funded ratio of the total DCR plan is above 100% consistently.

MR. LANGER said there are a few different thoughts tucked within the actuarial community about funding a plan. In the past three years there have been a lot of research papers written on this and how to treat closed plans and how to treat plans that become over 100% funded. The practice in the past for overfunded plans, particularly if they are open like Alaska's DCR plan, was to stop contributions if the plan got to roughly 15% to 20% overfunded. Now the thought process is more along the lines that it is difficult to turn on the funding spigot if you turn it off. He has worked with a few plans that were well over 100% funded, and they had no contributions going in during the 1990s or the early 2000s. When they went to turn the funding back on, it was very painful for these plans. So there is the thought now to continue to put in potentially the normal cost (cost of benefits accruing) as the minimum contribution and not running the contributions down to zero. That may work for the DCR plans. On Alaska's defined benefit plans, which are closed, he urged a bit more caution. Buck would probably want to slow down the contributions to the defined benefit plans or any portion of the plans that are approaching 100% funded. Looking broadly at the contributions to these plans, since the healthcare portion is close to or over 100% funded on the defined benefit plans, looking at pushing more or all of the extra contribution to pension is a reasonable way to go.

Chief investment officer GARY BADER asked, if the defined contribution plans are overfunded and the defined benefit plans are still underfunded, and the allocations in PERS are essentially a 22% employer contribution, if there was any reason why more of it could not be put toward the defined benefit plan.

MR. LANGER's response was no, that a shifting of extra DCR contributions to the defined benefit plan has occurred.

MR. BADER said he thought part of the 22% was allocated between the DCR and DB plans, but not that there was shifting from one fund to another.

MR. LANGER agreed that there was shifting from the excess in the DCR plan. He pointed out that the requirements of the DCR plan are not even close to the 22%, so you certainly would not want to put all 22% (PERS) or 12.56% (TRS) into those plans. It is not needed. Shifting the excess to the defined benefit plans makes all the sense in the world.

MR. LANGER said that ideally he would like to see all the components at roughly the same funded level, as opposed to being spread out from 67% funded up to 105%. That is what Buck's actuarial calculations strive to do, but, unfortunately, the experience of what actually happens compared to what they are expecting does not always line up.

MR. PIHL sought verification that, to the extent there is an overfunding situation in the DCR plan, it has nothing to do with the pension benefit but has to do with other benefits that the system provides.

MR. LANGER said the healthcare benefits make up the vast majority of the liabilities within the DCR plan.

Continuing with his review of the preliminary observations from the FY2015 valuations, MR. LANGER explained the PERS and TRS employer/state assistance contribution rates. He said that in developing these numbers Buck takes into consideration some of the events that will happen between the valuation date of June 30, 2015 and the FY2018 contribution rates. They roll the results up a couple of years, making estimates of the unfunded liability at that point, and then develop a payment toward that unfunded liability for pension and healthcare separately. That is how they develop the past service rate shown on slide 7.

- The total employer/state contribution rate for the PERS defined benefit plan is 21.78% for FY17 and decreases to 18.72% for FY18.
- The contribution rate for the TRS defined benefit plan is 23.40% for FY17 and decreases to 19.09% for FY18.
- The decreases are predominantly due to the retiree healthcare claims experience.
- The defined contribution rate paid by PERS employers is 4.36% for FY17 and 4.72% for FY18.
- The defined contribution rate paid by TRS employers is 4.62% for FY17 and 5.09% for FY18.
- The total rate, including the DCR rate paid by employers, is 26.14% for PERS in FY17 and decreasing to 23.44% for FY18.
- The total rate, including the DCR rate paid by employers, is 28.02% for TRS in FY17, dropping to 24.18% for FY18.

CHAIR ERCHINGER remarked that a lot of what the committee was seeing was the result of recent legislation that extended the amortization period and significantly reduced the normal cost because it is spread out over time. While acknowledging that every retirement plan is different, she still wondered if it was uncommon for Buck to see a normal cost rate of 5% for a plan similar to Alaska's, where a person is getting lifetime medical benefits in addition to their pension when they are fully vested. She always thought that the normal cost should be somewhere around the 9% range long term.

MR. LANGER responded that the normal cost, or the cost of accruing benefits, is driven by many different factors, but the biggest driver is the plan provisions. A plan that provides higher benefit levels, whatever that might be, will result in a higher normal cost of benefits. Other factors play a role, such as assuming a higher investment return than another plan that will make the cost lower, or using a different mortality table. He stressed that the contribution rates he just presented were net the member contributions to the retirement funds, so the overall total normal cost is in the low double digits. What he sees in practice is the total normal cost amount might be 7-8% of pay at the low end, and that usually covers a normal type employee. It will increase a little bit more for teachers. Where he sees the higher normal cost amounts of 25-30% of pay is in some public safety plans, which may allow for retirement after 20 years, so there is a shorter period of time over which to fund the benefits. He did not think the normal cost for the PERS and TRS plans seemed out of line. However, it is difficult to make those comparisons because there are so many differences in plan provisions and assumptions.

MR. KERSHNER said to keep in mind that the normal cost rates shown on slide 7 are percentage of total pay. As a percentage of just the defined benefit pay, it would be in the 8-9% range, which is typically seen.

MR. KERSHNER answered MR. PIHL that the employers pay 22% of the total contribution rate that includes the DCR rate, and the State assistance pays anything above 22%.

MR. LANGER noted that the ARC (actuarially required contribution) rate for the DCR plan is far less than the 22%. The retirement system still collects 22% of pay from the employers for the DCR employees. The background for that is so employers do not lean toward hiring only post-2006 employees because there is a cut in the contribution rate.

MR. PIHL questioned the footnote that the roll-forward projections assumed 0% population growth.

MR. LANGER said Buck was assuming that the number of active employees is the same in the FY2018 valuation as is in the 2015 valuation. However, the payroll increase assumption for individuals within the plans is in play for all years in the projection. The overall payroll growth is somewhere around 3%. He said boards often ask if the payroll growth assumption number should be adjusted because plans have been experiencing a flat payroll for years. When that is done, the adjustment has to be consistent. If a plan is not anticipating payroll increases due to contracts, Buck will bake that in. They bake it not only into the development of the unfunded liability contribution (which is a percentage of payroll), but they also bake it into the liabilities. So the liability projection is also lower, but the payroll is lower, and sometimes the rate of pay contribution washes in the end.

MR. PIHL stated there would be a cut in employee numbers across the state, in the face of a budget crisis. He thought the direction to the actuary (at the August meeting) had been no payroll increase from year to year. Whatever increases occurred in salaries would be offset by reduced numbers of employees. Therefore, the payroll projections going forward would be no increase.

MR. BOUCHER said it has been a subject of discussion, and his recollection from a previous meeting was zero percent population, not zero percent payroll growth.

MS. RYAN observed that if there are no new hires, and people are retiring, that is a net reduction in payroll, because new hires would be paid at the bottom end of the salary scale.

MR. BOUCHER said that people will move in place as well, so steps and columns will mean a wash in payroll, in general.

MR. LANGER stated that keeping the active population level the same from year to year is a somewhat common convention. If a plan is certain there will be a 10% cut in head count, Buck could adjust the valuations for that. In such instances, he always offers a word of caution and asks for something definitive that the cut will happen so they can bake it into the valuation. However, if the committee felt a zero payroll increase should be baked into the valuation, then Buck could consider it. It is not considered in the FY2015 valuations.

Regarding keeping the active population the same, MR. LANGER said the new people being hired are all going into the DCR plan, where they are getting a markedly lower amount of benefits hanging out there. The primary pension benefit is the contribution to the defined contribution plan, and that adjusts itself, so it is not necessary to worry about a lot of unfunded liability fluctuation there.

MR. PIHL remarked that it really affects the contribution projections. He understood the Governor's budget for next year includes a cut in personnel costs.

CHAIR ERCHINGER suggested putting this topic on a future agenda.

MR. PIHL said there has been talk in the actuarial work about the need for a benefit payroll for benefit projections, and a contribution payroll.

2. Consideration for Allocation of FY2017 State Assistance Between Pension and Healthcare

MR. LANGER said it was mentioned earlier that there is a disparity in the funded ratio between pension and healthcare in both PERS and TRS. Healthcare claims experience is the primary driver of the disparity such that healthcare is at or near 100% funded in both plans. Consideration could be given toward allocating all the state assistance contribution to pension to begin to narrow the gap. For PERS, that represents shifting $19.2 million of the FY2017 state assistance to pension that would have gone to healthcare. For TRS the shift from healthcare to pension would be $21.3 million. The impact of shifting those amounts from healthcare to pension would raise the funded ratio of PERS pension from 66.7% to 66.8%, and the healthcare funded ratio would go from 98.8% to 98.5%. The message is a continuation of what Dave Slishinsky said with regard to the large state assistance contributions that went in during FY2015: the healthcare plans are very well funded, and more of the money should be shifted to pensions, to the extent it can be done. The contributions have been adjusted over time, as the needs of healthcare have become less, but now everything should be put into pension and let the healthcare side idle for a little bit.

MR. LANGER said Buck proposed implementing that for the valuation they are working on right now. Further, Buck recommended considering shifting more revenue to pensions instead of retiree healthcare, as allowable.

CHAIR ERCHINGER asked committee members what they thought of supporting the recommendation to shift the total contribution to pension and allocate zero to healthcare.

MS. HARBO thought it was a good idea because the retirement plans would continue to have lower medical claims costs because more retirees will be covered by Medicare.

When CHAIR ERCHINGER asked if that was a motion, MS. HARBO indicated that it was.

COMMISSIONER FISHER asked if Buck was recommending a one-time event that would be evaluated each year, or if they meant a long-term change in the way contributions are allocated.

MR. LANGER responded that it is something that Buck would keep coming back with for the next several years. However, he suggested making this a one-year motion that would be revisited each year. When everyone is more comfortable with it would be the time to make a more permanent motion. Buck wants to keep reviewing the whole issue of disparity between pension and healthcare funded ratios, and next year the recommendation may be a little different.

CHAIR ERCHINGER reiterated Ms. Harbo's statement in the form of a motion: A recommendation to the Alaska Retirement Management Board to accept Buck's recommendation to shift the allocation of state assistance for one year so that zero percent goes to healthcare and 100% of the state assistance goes to pension in both the PERS and TRS systems.

MR. TRIVETTE seconded the motion.

MR. TRIVETTE said he assumed by doing this that it was not shifting more of the burden onto the municipalities. He would vote yes if he was assured that was not the case.

MR. LANGER stated that Buck's intent is to keep the basic actuarial calculations the same: pay the cost of benefits occurring and then a 22-year payment period for the unfunded liability. Once those numbers are developed and split between the state and the employers, then those dollar amounts are shifted. So it is not charging the employers more under the shifting proposal.

MR. PIHL asked about the other allocations, saying that the employee contributions have always been 99.7% to pensions.

MR. LANGER said the employee contributions are by plan design and are not a function of the actuary. He added that the employer portion is something more for Buck to explore with staff, as it gets into the comment about shifting more toward pension as allowable.

MR. PIHL said he agreed with the one-time shift of FY2017 state assistance from healthcare to pension, and he thought it should have been that way long before. He did not want his vote interpreted as agreeing with the prior allocations. He understood that Mr. Worley would get the analysis to Buck to look at, and Buck would comment on it at the next meeting.

MR. LANGER acknowledged that Buck would be doing that.

COMMISSIONER FISHER questioned why there was a contribution of $21 million shown under TRS healthcare for FY2017, when the FY2015 valuation has more assets than liabilities.

MR. LANGER explained that it is the fiscal year 2017 state assistance contribution, and that amount is based upon the June 30, 2014 valuation.

MR. KERSHNER referred to slide 6 to illustrate that the TRS healthcare funded ratio in 2014 was only 77%.

MS. RYAN asked if Buck was seeing any trend in the age of retirement when they are calculating how much healthcare is going to cost. Tier II for TRS and Tier III for PERS are now beginning to hit retirement, and she thought some people were working beyond the age at which they become eligible to retire. That may be where the reduction in healthcare costs is coming from.

MR. LANGER stated that Buck bakes the retirement rate into the valuation model. When they develop those rates they base them upon experience seen within the plan. The last time Buck reviewed experience, it was for four years, and they implemented a change in assumptions for the 2014 valuation. If Ms. Ryan was talking about an emerging trend, Buck would not have been able to observe retirements for some of these groups and would have had to make some estimates based upon professional expertise. However, when Buck looks at retirement as a source of the change in liabilities from one year to the next, it has been a relatively small number. It is not the several-hundred-million-dollar impact that Buck saw from healthcare, and the addition of the state assistance amounts was tens of millions of dollars. Retirement can be a driver for the difference between what Buck thought would happen in the liabilities and what actually happened, but this past year it was one of the more minor drivers.

MS. RYAN said her point was that she thought the systems were going to see older retirees in Tier II of TRS and Tier III of PERS because these people do not get the same benefits at retirement as earlier tiers.

MR. LANGER said that was a good observation. Buck bakes that into the valuation year by year as they see people stick around longer that what they anticipated. So they might see small decreases in the liabilities from that. However, longer-term trends are baked in every four years with the experience review. Broadly across other plans, with the flat payrolls that Buck has been seeing, the trend is that people are not retiring as soon as they would have in the past. The overall economy is sort of driving that.

CHAIR ERCHINGER asked Mr. Langer if his intent was for the committee to recommend to the full Board accepting Buck's recommendation to shift the allocation of only state assistance toward pension, or if he also wanted the employer and employee contribution portions shifted to pension, or if the second part was to be a separate discussion later.

MR. LANGER replied that nothing can be changed for the member contributions. Buck needs to consider some more input from Department of Administration staff regarding the employer contributions. But to the extent that employer contributions can be shifted, he thought that was a good idea. To the extent that it can be done for the fiscal year ended 2017, those contribution amounts have not gone in yet. If employer contributions can be shifted as well, that would be a good idea.

MR. LANGER proposed that the motion could be amended to say "and employer contributions, if Buck, in consultation with staff, determined that it is allowable."

Hearing comments from a couple of committee members, CHAIR ERCHINGER said that if there was no objection she would rather the committee voted on the motion as stated, related to just the state assistance piece. The committee does not want to interfere in the operations of the Department of Administration and Buck having a thorough conversation about the impact of shifting other contributions.

The roll was called, and the vote was unanimous, 6-0.

MR. TRIVETTE spoke in favor of also shifting other contributions toward the pension portion of the unfunded liability, and as quickly as possible.

MR. BOUCHER said he was in general agreement with the direction this was headed, and he was pleased that it was limited to state assistance at the moment. His caution was about how much the healthcare has moved in such a short time, because if it goes in the other direction suddenly (which healthcare trends can), everything could get jerked in the other direction. He added that a significant portion of the overall costs for over-65 retirees is pharmacy, and that trend is now approaching 20% year-over-year growth across the nation. Some of the good things being seen in the retiree trend are being offset by other aspects. He hoped the current trend could be maintained because it is fantastic to see the plan change from the level of funding it was years ago to where it is now. It would also make the reporting of OPEB (other post-employment benefits) for municipalities much less.

MR. PIHL said that if each year the allocation was based on the unfunded balance coming forward it would be self-adjusting.

3. Payroll Reconciliation of June 30, 2015 Valuations

MR. LANGER referred to slide 14 of the Buck presentation. He said the amount of payroll that the Division of Retirement & Benefits (DRB) reports to Buck is different from the payroll in the valuation report. Buck does some things to the valuation payroll to ready it for the actuarial projections, including annualizing the information received for new hires and part-time employees. Buck also uses assumptions to project estimated future salaries, in order to develop estimates of future benefits.

MR. LANGER said the payroll increase shown between (f) payroll used for contributions as of 6/30/15 and (g) payroll used for contributions as of 6/30/17 for PERS is about $120 million over the course of two years, or roughly a 2.5% annual increase. So the assumptions are the primary adjustment to the payroll information that Buck receives. He said consideration could be given to flattening that amount if there is a consensus on that. His caution there is to do it on both the liability side of the house, as well as development of the contributions. Many times it ends up being a wash on the contribution rates, but not always.

MR. PIHL stated that the last roll-forward Buck provided on PERS had a $72 million disparity between the DRB payroll and the payroll Buck used on the contribution side. Now the difference was $76 million too high, and he did not understand it. The DRB payroll is the payroll on which contributions are going to come in. He recalled that this was discussed and agreed that the funds were going to come in on that basis, and that GRS had also tuned in. When Buck starts with a payroll number that is too high, and projects an increase on it over 25 years, it introduces a huge disparity. The contributions are too high, and particularly when it is applied to percent of pay going forward. It results in more back-loading.

MS. HARBO asked why Buck annualized part-timers instead of using full-time equivalency. She thought annualizing resulted in a much bigger number.

MR. LANGER replied that much of the annualization going from (c) to (d) is due to new entrants into the plan.

MR. KANASTER added that when Buck is calculating the liabilities they are looking for a benefit based on monthly salaries. Looking back in time, they need to annualize the part-time employees to get a best estimate as to the active part-timers' liability. Buck pulls that out for the contribution, because then they are looking for total payroll and not the liability calculation.

COMMISSIONER FISHER asked if the ARMB has ever looked at the accuracy of the assumptions.

MR. LANGER responded that the process for reviewing whether the results are right or wrong is the experience review process done every four years. It was last done for the June 30, 2014 valuation. He said there are some assumptions that defy logic: the investment return assumption is not based upon things that are happening in Alaska necessarily, but broader world economies that drive investment returns. It is impossible to predict, so Buck takes a long-term look at that. With retirement, typically what has happened in the past five to ten years is a good predictor of the next five to ten years, and maybe beyond that. Getting into salary assumptions, it is sort of in-between: overall payroll increases tend to be driven by the overall economy, and then it is tweaked by employer pay practices. In the past five to seven years, in actuarial reports broadly and not just Alaska, Buck has over-estimated the payroll going forward. They adjust it in the valuation when they collect new payroll numbers.

MR. PIHL said he has been watching payroll for a number of years, and he has seen a consistent difference between the contribution payroll that DRB supplies and what Buck is using in the projections of contributions going forward. It started with $90 million higher in PERS and a $60 million difference the other way in TRS. Based on the numbers on Buck's slide 14, it looked like the differences were going to continue.

CHAIR ERCHINGER thanked Buck for providing the reconciliation. She hoped that when the committee had an opportunity in the future to talk about funding policy maybe it would help the committee make decisions about some of the smaller items that in the aggregate will help reconcile some of the outstanding issues.

CHAIR ERCHINGER asked Ms. Thompson of Gabriel Roeder Smith (GRS) if she had any comments.

MS. THOMPSON stated that Buck was still responding to GRS's review questions, so it was a little early for her say much on the overall audit. Regarding Mr. Pihl's statements about the allocation and how the unfunded pension liability flows through to the financial statements of the State, if she were on the committee, she would want to discuss the allocation and related impacts under the new GASB standards. This happened because of the new standards for pension reporting, but OPEB (other post-employment benefits) new standards are coming that create blended rates and potentially higher liabilities. So before making any permanent changes on allocation, she advised looking at that first. It is not effective yet, so it does not impact the Alaska plans this year.

Responding to MR. PIHL's query for her thoughts on the payroll reconciliation, MS. THOMPSON said Buck will never match the DRB payroll because the actuary is moving the salary scale forward a year. Buck calculates a liability, then they look forward a year and say this is what is coming in to pay off that liability. She said the committee could argue about whether Buck should do that or not, but that is what they are doing. What she did not yet understand is why the TRS item (f) is lower than the actual reported salary, but maybe she had to do a deeper review of that. GRS replicated Buck's numbers, and Buck has the same starting payroll numbers as Mr. Pihl's analysis. It is what they do with it after – they apply a year salary scale because the liabilities will get paid off in the future. She is okay with that because Buck now has the same starting point. As a result of all Mr. Pihl's work, Buck has figured out the part-timer issue and the annualization. Now there is a contribution rate payroll and a valuation payroll.

4. Healthcare Data Review and Inclusion in Valuations

MELISSA BISSETT reported that Buck has looked at everything that is included in the valuations. Buck uses a four-year rolling average on health claims experience that the claims administrator reports to them. Every year that data shifts as old data falls off and new information comes on. The new information coming on has been lower than the information going off. Of the big gain in healthcare claims experience, at least half of it is due to experience improving over time. That has a lot to do with marketplace forces and general underwriting cycles. She referred to slide 17 that shows there is still year-to-year volatility, but there has also been a recent change in the claims administrator. Buck tries to account for that, but it still has some impact on year-to-year claims, and it usually has a bigger impact on the year the new TPA goes into effect. Further, there is margin in a lot of the assumptions for adverse deviation. This includes trend, any savings that are projected for changes in contracts, claim reporting lag factors, and participation factors. Buck strives to get to figures that provide results that have adequate funding, and certainly not to underfund significantly.

MS. BISSETT said the margin is probably another topic for a future conversation, but it is not the biggest piece in the data she was showing. The biggest piece is the claims and partially the lag. When Buck comes up with per capita claims contributions in any one year, that most recent year does include a completion factor, because they have most of the incurred claims but there are still some claims that have been incurred that have not yet been reflected in the TPA's reporting. Buck does not see the true experience on that until a couple of years later. They may find that what they had projected was a little too high, and then on top of that the claims experience was down. Sometimes when the claims are lower than expected, that claim reporting lag factor is a little more magnified. Buck has updated the claim reporting lag factor this year because now they have new, more credible information from the new administrator that they are paying claims faster so there is not as much lag. Buck is putting in less of a completion factor in the most recent year. These are all things they do as they see the data, because they cannot just estimate but have to base their rates on the experience that they are seeing.

Regarding the other pieces, MS. BISSETT said one thing Buck found was some rebates that they thought were included in their experience reporting historically. Through research with Finance, they found out that the rebates were not part of Aetna's reporting but were actually coming through in a different line called "other premium recovery." What Buck had thought was only retiree drug subsidy reimbursement actually included some rebates. Buck reflected that in the claims rate development for this year. There is some historical stuff that was not reflected in the rates, but it is actually a very small amount, about 1%. Taking everything into consideration for the gain on healthcare, there is really only about 2% left due to the margin that is in the assumptions. As Mr. Boucher mentioned earlier, there is some volatility in the healthcare claims experience, which leads Buck to include some margin in the assumptions going forward.

MS. BISSETT stated that Buck wanted to make sure that they were using appropriate reported claims. They compared the claims that were reported, and which they used in the claims rate development, to the benefit payments that were shown in the asset statements. Generally, the amounts were close, with a bit of variance over time. Buck feels comfortable that they had the appropriate benefit payments and were not misstating something in that information. Through that research they discovered the rebates that need to be accounted for going forward, although it is considered a small amount.

5. Background on Getzen Model Healthcare Trend Rate Model
Information was included on slide 18 of the Buck presentation.

6. Best Practice for Healthcare Trend Rate Assumption Change
Information for education was included on slide 19 of the Buck presentation.

B. Review Actuary Update

MS. THOMPSON mentioned that at a meeting last fall Buck's Todd Kanaster had presented some proposed changes designed to make the timing of the valuation process go better. That has been extremely successful, from GRS's point of view. She said this is the best year GRS has had for getting valuation things earlier and allowing them a lot of time to review. She thanked Buck for working through that and getting the material to GRS.

MS. THOMPSON informed the committee of the larger items she is working on. In the seven or eight years that GRS has been the review actuary, she never realized before that Buck does not appear to be using the actual retiree medical data on the people. Buck is using pension data and using it as a proxy based on the assumptions. She is trying to validate if that is true, and secondly, to see what the implications are of not using actual retiree medical data, as the topic of margin is talked about. She dug into this deeper this year because she is greatly disturbed at a billion dollar positive healthcare claims experience. She was not arguing with Buck's data, but she wondered if Aetna reduced costs so much because they wanted the business or if there was some market trend reversal about to hit.

MS. BISSETT stated that Buck usually sees a drop due to discounts when a new provider contract is negotiated, but then there is a creep back up over time to make up for that. It is also possible for some of those cyclical changes to happen.

MS. THOMPSON mentioned that earlier Ms. Harbo had raised the excellent point that retirees are moving into Medicare eligibility. Her first thought was that that should not cause gains or losses in the valuation liabilities because Buck's valuation system predicts the timing when that will happen and predicts the resulting reduction in claims. There are other sources of big gains that are puzzling to her as well, but most of all it is the medical claims.

MR. BOUCHER commented that the department is working with GRS and Buck on the actuary's use of pension data as a proxy, instead of using retiree medical data. He said the medical data is available, so he is trying to figure out what the issue is.

CHAIR ERCHINGER expressed appreciation to the Buck representatives for working so diligently to get information to GRS.

C. Future Best Practice Topics:

1. Health Margin

2. Closed Plan Assumptions

3. Development of Funding Policy

4. Others

CHAIR ERCHINGER stated that the committee has talked about what it would like to see in terms of education, as well as learning about best practices in other actuarial committees, in closed plans, etcetera. In trying to formulate what future agendas are going to look like, she said it would be helpful if trustees have any other items that they would like to include on this list, in terms of best practices. The committee can then ask Buck and GRS for help on where to find information on best practices.

MR. TRIVETTE reported that he and Ms. Harbo attended a public pension trustee conference in October 2015. GRS has done some major work with the State of Colorado and was one of the presenters at the conference. He intended to ask Ms. Thompson to send a copy of that report so the committee could get some ideas.

MR. PIHL expressed hope that the whole topic of allocations would be looked at to see how it has played out over time and to see if there is a better practice for tracking with the unfunded liabilities than what he has summarized.

D. Future Committee Education Topics:

1. Impact of Cadillac Tax

2. Liquidity

3. Smoothing in Closed Plans

4. Others

MR. BOUCHER stated that something happened at today's meeting that could happen more often, if care is not taken. One is there was a misunderstanding, or at least what appeared to be a misunderstanding, about the direction given to Buck related to a particular item. He proposed thinking about a bit more formalization to make sure that the "asks" are in writing, because there is opportunity for Buck to spend valuable cycles on something that misses the mark. One item is the request to review the allocations over a period of time. He wanted to make sure that proper direction is given so that the committee gets what it wants.

CHAIR ERCHINGER agreed that was a good idea, saying that item E coming up next touches on that also. She said if there were no other committee education topics at this time, then committee members could bring them forward as they come up. Otherwise, the committee would start working on the existing list.

E. Recommendations to the Board

CHAIR ERCHINGER reminded everyone that this committee is working in concert with Buck and GRS in trying to resolve some of the outstanding audit findings, and making decisions. The decisions need to be ratified by the full Board, and she has been struggling with how best to do that. The committee made two major decisions at the September 23, 2015 meeting that were brought forward to the full Board in the form of resolutions. One was a resolution on the employer contribution rate, and one was a resolution requesting to reinstate asset smoothing.

CHAIR ERCHINGER said that, in order to get the full Board to ratify additional actions that the Actuarial Committee has taken, she needs to do a better job of remembering at the end of her committee report to ask for concurrence of the full Board of the actions that the committee has taken. At tomorrow's board meeting, she would put forward the recommendation from the committee today when it voted to recommend accepting Buck's recommendation to shift state assistance allocations 100% toward pension and 0% to healthcare for just the coming year.

CHAIR ERCHINGER said she did report to the Board on the committee's actions in the previous meeting when it reviewed the audit findings, in concert with Buck and GRS. However, she intended to go through these briefly as to the specific directions the committee gave and ask the full Board to concur with that. She hoped that would get to what Mr. Boucher was asking for, which is clear, on-the-record direction. Regarding asking Buck to review Mr. Pihl's contribution rates, she said she was not asking them to go back and replicate his work but for them to see what Mr. Pihl has done. She understood that request has to go from the ARMB Chair and not from this committee.

MR. TRIVETTE said he appreciated Mr. Pihl getting the issue on the table that how some of the calculations are done may impact municipalities. He is more of a policy wonk himself and really depends upon two or three of the other trustees to bring these issues up for discussion.

VIII. Future Meetings

A. Calendar Review

The calendar was included in the packet.

B. Agenda Items

CHAIR ERCHINGER stated that Buck commented that talking about 0% population growth can lead to discussions about reducing future salary growth and a whole can of worms that has not been discussed in depth, and that probably should be discussed to learn these types of impacts. That topic for a future board meeting would be relative to the decision regarding 0% population growth, and are there additional discussions needed about payroll growth, salary growth, and etcetera.

CHAIR ERCHINGER said she had asked if Buck could look at whether the primary driver is healthcare claims experience or also state assistance allocation, with regard to the funded ratio of the healthcare plan. That is a request that Chair Schubert will have to weigh in on and approve, as well as whether or not to give Mr. Pihl's report to Buck so they can see what he is talking about regarding the past allocation between pension and healthcare.

CHAIR ERCHINGER also put on next meeting's agenda a discussion about changing the allocation of employer contributions to pension only, in follow-up to the Buck conversation with the Department of Administration that will take place in the interim. The committee will need more information for that discussion.

MS. RYAN said she fully supported that whatever requests the committee makes to Buck be clearly stated, and she preferred the requests in writing so they zero in on exactly what the committee is asking for, so nothing unnecessary is done, and so there is no time delay.

C. Requests/Follow-Up – None.

ADJOURNMENT

The meeting adjourned at 3:50 p.m., on a motion made by Ms. Ryan and seconded by Ms. Harbo.

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