State of Alaska
ALASKA RETIREMENT MANAGEMENT BOARD
ACTUARIAL COMMITTEE MEETING

Centennial Hall - Hammond Room
101 Egan Drive
Juneau, Alaska

March 1, 2017

ATTENDANCE

Committee Present: Kristin Erchinger, *chair (on-line)*
Tom Brice
Commissioner Sheldon Fisher
Gayle Harbo
Rob Johnson
Norman West
Bob Williams

Committee Absent: --

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

Department of Administration Staff Present:
Ryan Colgan (deputy commissioner)
Ajay Desai (director, Division of Retirement & Benefits)
Kevin Worley (chief financial officer, Department of Retirement & Benefits)

Others Present:
Larry Langer (Conduent, actuary)[1]
Melissa Bissett (Conduent, actuary)
David Kershner (Conduent, actuary)
Leslie Thompson (Gabriel Roeder Smith & Company, review actuary)

I. CALL TO ORDER

Acting as chair at the meeting site, because Chair Erchinger was going to participate by telephone, GAYLE HARBO called the meeting to order at 1:30 p.m.

[1] Formerly Buck Consultants

II. ROLL CALL

Six committee members were present to form a quorum. Commissioner Fisher joined the meeting in progress.

III. PUBLIC MEETING NOTICE

MS. HALL confirmed that public meeting notice had been met.

IV. APPROVAL OF AGENDA

MR. JOHNSON moved to approve the agenda. MR. BRICE seconded. The motion passed without objection.

V. PUBLIC/MEMBER PARTICIPATION, COMMUNICATIONS AND APPEARANCES

There were no members of the public who wished to address the committee.

VI. APPROVAL OF MINUTES – December 7, 2016

MR. WEST moved to approve the minutes of the December 7, 2016 meeting. MR. BRICE seconded. The minutes were approved as presented.

VII.

A. Discussion Topics

1. Allocation of Expenses Between Plans

KEVIN WORLEY, chief financial officer in the Division of Retirement & Benefits, referenced a discussion at the December committee meeting about the allocation of expenses between the retirement system plans.

[A detailed written explanation of the allocation of expenses between plans, under the heading of Chief Financial Officer Report, was provided in the committee packet and is on file at the ARMB office.]

He said it is a two-fold process because the Department of Administration, as well as the Department of Revenue, allocate costs to the plans. Both departments use a company called Maximus Consulting Services, Inc. to develop a statewide cost allocation plan for services. Speaking for the Division of Retirement & Benefits, MR. WORLEY said there are two types of costs – direct costs and indirect costs. For a majority of the invoicing, DRB will either charge a plan for direct costs, or they know that some of the work was done for the benefit of more than one plan. Since 2008, the division has used an allocation process that was developed with the assistance of Maximus to determine different bases of allocation, be it the number of retirees in a plan, the number of members in a plan, or they could use dollars. It depends on what type of charge DRB has to allocate to the plans.

ACTING CHAIR HARBO remarked that the written explanation contained a lot of information.

MR. WORLEY mentioned that each section of DRB is responsible for a set of employees. Within those employees, they are assigned to do work for certain types of plans. For example, the personnel section of the accounting side is able to trace the cost allocation based on how many payrolls they process for a particular plan and how much time it takes to process those.

MR. WORLEY said he hoped the write-up answered most of the questions. He noted that Mr. Johnson had submitted a couple of questions a few days ago.

MR. JOHNSON said he assumed that the general operating expenses of the Department of Administration were not treated as a "plan" in the cost allocation formula.

MR. WORLEY replied that the Department of Administration has a number of divisions, and there are separate appropriations for those divisions. They are all accounted for separately. Within the Division of Retirement & Benefits (DRB), they have authority to spend trust funds, as well as some general fund. The trust funds are PERS, TRS, JRS, SBS, Deferred Compensation Plan, the health trusts, and a few others. How DRB spends those will be different, determined by the allocation process they use. They are not charging general Department of Administration costs to any of these plans. Specifically, the EPORS (Elected Public Officers Retirement System) benefits are appropriated through the general fund appropriation.

COMMISSIONER FISHER stated that the general fund allocation for the Division of Retirement & Benefits is very small and covers the PICORI contribution (Patient-Centered Outcomes Research Institute fee) and some actuarial work that the division does for the legislature that cannot be charged against the trust fund money. Virtually everything else that funds DRB is trust fund assets, allocated according to the formula laid out in Mr. Worley's written explanation.

MR. JOHNSON inquired if things like the cost of computers, technology, and office space were allocated to the trust funds – for example, computers that run retirement fund calculations and also run the active employee payroll.

Following that example, COMMISSIONER FISHER stated that there is a group that processes payrolls for active employees, and they have an interagency fee that is charged to other agencies to do that service. One of those agencies that is charged is the Division of Retirement & Benefits, so DRB pays a fee to have the payroll run for their employees. Further clarifying this for Mr. Brice, the Commissioner said the portion of the fee associated with those DRB employees would use trust fund money.

COMMISSIONER FISHER also provided some deeper background on how different types of costs are allocated. He said that each component – for example, telephones – has its own formula, which makes it hard to be as precise as committee members would like the explanation of cost allocation to be. He added that if there was an interest, staff could try to pull some more information.

MR. WEST commented that this is an entire field within management accounting and is pretty well perfected. The only real question for him was if there had been any changes, because he believes the allocation methods should be consistent over time. Talking about a government unit, his concern would be some political or other pressures to try to change those allocations periodically. Generally, when allocating administrative expenses, it should be a total allocation with zero leftover.

MS. ERCHINGER stated that she got the general idea that fifty percent of the costs are based on the number of members and fifty percent on the outstanding assets in the plans. While that seems to make logical sense, there is a PERS (Public Employees' Retirement System) plan and a TRS (Teachers' Retirement System) plan that both have significant asset values. Yet, the PERS defined benefit plan especially will take less and less work over time, even though the asset values are high. It seemed to her that the actual effort going in will be more and more geared toward the defined benefit. Some of that is captured by the direct costs actually being allocated there. She wondered, however, if there was any recognition that over time there might need to be some sort of adjustment in the methodology to recognize the change in the nature of that particular plan.

MR. WORLEY responded that the division had gone through a number of changes in the last six years, through different reorganizations. The division monitors those to see if there is an impact on the cost allocation process. For any changes in the future, such as Ms. Erchinger brought up, the division will look at the methodology.

2. Allocation of Assets Between Police/Firefighter and Other

MR. WORLEY stated that this allocation came up in a discussion during the December meeting, in the context of the Actuarial Committee proposed manual where it talks about the allocation of the actuarial value of assets between the Peace Officer/Firefighter and the all Other, within the Occupational Death and Disability group. Those are accounted for in separate funds. In following up with Ms. Thompson of GRS, he realized that the confusion between he and Ms. Thompson at the December meeting was about actuarial value and market value.

LESLIE THOMPSON of Gabriel Roeder Smith & Company, the review actuary, said that when GRS was conducting their review they noticed that when the allocation was done the funded ratios were the same for the two funds. That made her wonder if that was how people wanted it, because the assets may be behaving differently between those two different funds. She found out that DRB does an allocation between the two funds.

MR. WORLEY clarified that the revenues are directly deposited into the proper funds. So, the Occupational Death & Disability rate charged for Peace Officer/Firefighter goes into that fund. All others go into the Other fund.

MS. THOMPSON asked if that was true for PERS pension as well.

MR. WORLEY said not for PERS pension, but only for defined contribution.

MS. THOMPSON stated that she now understood for PERS defined benefit that DRB does the allocation on the total fund. They then turn around and do an allocation of the actuarial value of assets so that the funded ratios are the same between Peace Officer and Other.

DAVID KERSHNER of Conduent Human Resources Services said that PERS defined benefit plan has one contribution rate for pension and one contribution rate for retired medical, whether it is Peace Officer/Firefighter or all Others. So, the actuary does not need to allocate the actuarial value of assets in the PERS defined benefit plan between Peace Officer/Firefighter and all Others. The defined contribution plans are more distinctive because there are separate contribution rates.

MS. THOMPSON said it was her recommendation that this get discussed, not necessarily at this meeting, but for Conduent to explain whether Peace Officer/Firefighter or Others could come back and say that it was not fair. She recommended this as part of the experience study, when the committee and board will be looking at some of these issues in more detail.

MR. KERSHNER said it was more relevant for the defined contribution plans because they get different contribution rates, but not so much for the defined benefit plan because there is one contribution rate, regardless of which group a member is in.

3. Funding Policy – Normal Cost as Minimum Contribution

MR. WORLEY reported that he looked through the statutes to determine if the Board or the committee, looking at the contribution rates, wants to defer all or a portion of the employer contribution rates for PERS and TRS to pension versus healthcare. Statute AS 39.35.255(b) states that "The administrator shall allocate contributions received for full payment of (1) the actuarially determined employer normal cost for the plan; and (2) all contributions required by AS 39.30.370 and AS 39.35.750 for the fiscal year." AS 39.30.370 and AS 39.35.750 refer to defined contribution plan contributions, so the employer match, the Occupational Death & Disability, the retired medical insurance, and the Health Reimbursement Account (HRA) contributions. Item (1) above refers to the normal cost for the defined benefit plan pension and healthcare.

MR. WORLEY stated that under 39.35.255(c) it states that the administrator shall apply the remaining portion *(after normal cost and the defined contribution plan contributions are paid)* for payment of the past service liability of the plan. He also found that the definition of "plan" means the retirement plan established under statutes for the defined benefit plan and the statues for the defined contribution plan. So, "plan" under these definitions does a combined pension/health.

MR. WORLEY said that it appears that the past service liability portion of remaining employer contributions that is available to be applied to the past service liability could be used as determined by the consulting actuary, or it could be split in a manner such that all past service liability payments can go to pension or health or some alternative allocation, if it was so desired.

Last year at this meeting the committee talked about directing the entire employer contribution to pension because of the funding level. It was decided that the additional state contribution amount would go to the pension plan only. MR. WORLEY said the reason he wrote this up was to express that, at a minimum, the normal cost payment, as actuarially determined, has to be made to pension and health. While he would like to see all the money go to the pension plan in order to raise the funding ratio, he believed the Board was bound by a normal cost contribution to the health plan but could direct the rest of the funds to the pension fund. The same statute wording applies to the Teachers' Retirement System as well.

MS. THOMPSON stated that part two of where this came up is the PERS defined contribution plan. There is a normal cost contribution, and the plans are overfunded or have a surplus. That is getting subtracted from the normal cost so that the required contribution is actually less than the normal cost. She said what came to her attention, in terms of the funding policy, when she was drafting the committee manual was shouldn't it be the normal cost plus the amortization payment, but not less than zero on the amortization payment (instead of saying the contribution is normal cost plus the amortization payment). Then it would always be paying the normal cost. She was looking for direction on whether that should be the funding policy. If so, Conduent would have to change some of the valuation results. None of it is probably a big-ticket item today, but it could grow into that as the plans get fully funded.

MS. THOMPSON said that a couple of meetings ago Chair Erchinger had brought up talking about the budget process at the municipal level and having the employer contribution go up and down. That stabilization of budget may have some merit in discussing this topic as well.

MS. THOMPSON said that at the last meeting Mr. Worley had introduced the discussion of transferring assets from a place that was "too fat" to a "skinnier" place. It sounded to her like that can be done, as long as the normal cost minimums are being met. The third item to be discussed is the state assistance and whether it can be zero to healthcare so that it all goes to pension – so long as the normal cost is met.

MR. JOHNSON stated that the Alaska Retirement Management Board (ARMB) sets a contribution rate, and the Board, to his knowledge, is not the one that sets the determinations on whether the money goes to pension or to healthcare. He thought the plan administrator does that. The Board, in order to set the contribution rate, needs to have information, such as the amount of money that would be necessary to fund all the elements. In terms of a manual for the operations of the Actuarial Committee, the focus

is on what it takes to actually set the contribution rates. When it comes to the actuarial valuation process, the plan administrator is the one who decides how the chunk of money goes to pension and healthcare. When the funds were created way back, it was just a single contribution rate. The idea of splitting it into pension and healthcare never occurred to anyone because, among other reasons, there was no healthcare at one point in time.

MS. ERCHINGER commented that, based on what Mr. Johnson just said, it begs the question when the ARMB is setting the contribution rate by resolution about why the Board is breaking the rate down into pension and healthcare, if that is not something the Board is charged with.

MR. JOHNSON's response was that being charged with something does not prevent the ARMB from using the other provisions and taking all other steps necessary to accomplish its directions. The ARMB can certainly advise and coordinate with the administrator.

B. Valuation Review – Key Takeaways from FY2016 Valuations

LARRY LANGER, DAVID KERSHNER and MELISSA BISSETT of Conduent Human Resources Services were in attendance to present the preliminary actuarial valuation results of the FY2016 PERS and TRS defined benefit plans and defined contribution plans to the committee. *[A copy of the Conduent slide presentation dated March 1, 2017 is on file at the ARMB office.]*

MR. LANGER reported that effective January 3, 2017 Buck Consultants became Conduent Human Resources Services. He saw it as a reversal of the merger that happened in 2010 between Xerox and Affiliated Computer Services (ACS). Buck Consultants was part of ACS in 2010, and the two firms merged into Xerox. All the elements that are now part of the Conduent business were originally part of ACS, with changes along the way. He did not anticipate any changes in doing business with the Actuarial Committee, the ARMB and the Alaska retirement systems.

MR. LANGER stated that the actuary's primary responsibility is to help determine the contributions to the retirement systems, or what he thinks of as a glorified budgeting process so there are sufficient funds to secure the plan benefits. He went on to list other responsibilities: disclose the liability measures; develop required accounting measures; review the current funded status of the retirement systems and explain why the funded status changed; and report on the trends in contributions, assets, liabilities, and funded status over the course of time.

MR. LANGER briefly reviewed the various inputs and outputs of the valuation process *(slide 4)*. He mentioned the notable improvements to the process as part of the FY2016 valuations. The first is more interactions with GRS (review actuary). Conduent and GRS have spent more time working collaboratively with each other during the course of the valuation process, partly because of instruction from the Actuarial Committee last year.

When Conduent is finished with the valuation report, hopefully they are finished, because they have baked in considerations from GRS along the way.
MR. WILLIAMS said that in the past the process felt unfinished when it reached the committee because there had not been as much communication with GRS. He appreciated the extra collaboration between the actuaries that results in a more finished valuation product now.

MS. BISSETT addressed the next improvement in the valuation process: the use of real retiree health plan enrollment data in the place of estimates based on using proxy census data. She said this year they went through the whole reconciliation and found some additional information on people who get dual healthcare coverage through coordinated benefits with their spouses.

ACTING CHAIR HARBO said it was not clear to her why it has taken ten years for Conduent to find out that hundreds of plan members have spouses who are also in a public plan with health coverage that results in coordinated benefits for both of them.

MS. BISSETT explained that she always compared the census data she used with the third-party administrator's data, and the numbers were sort of close. The reason was because the administrator was counting the people twice as well on their enrollment data because that is how they have to administer them. It was only when Conduent obtained the raw data on who is really covered that she discovered that people were listed as a retiree covering a spouse and also as a spouse covering a retiree. She said she wished it had been discovered sooner, but she was happy to be able to clean up the retiree health plan enrollment data and get a more accurate value for that benefit.

MR. WILLIAMS said he understood why it was ten years, because proxy data was being used for a long time. What made him nervous was that it changes the valuation and the costs. It turned out to be a $204 million savings over the life of the plan. Had it been a $204 million cost to the plan, the ARMB could have been vilified in the papers. Those changes are important, and he was glad the actuary has more accurate data to use now.

COMMISSIONER FISHER remarked that the enhancement of $204 million on that period has been replaced, because of the correction, by a loss of $175 million when netted out. The net-net impact of the change was very modest. He agreed with Mr. Williams, that had the numbers gone the other way, everyone would have been embarrassed.

MS. ERCHINGER stated that she was unclear on why there was almost a $200 million actuarial loss on retiree healthcare for this year.

MS. BISSETT explained that part of getting the new exact data is having a better picture of the ages of the people who are actually enrolled. Last year, Conduent thought the pre-65s were a little bit older than they had been in the past. It turned out that those pre-65s are really still closer to 60. On top of that, which she thought was the piece that was really

driving this, is that the post-65s are actually also a little bit younger. So, these people are in the plan for another year to a year and a half longer than previously assumed.

MR. KERSHNER stated that the third significant improvement in the valuation process was building in an assumption for anticipated rehires during the year. Normally, assumptions are set and kept in place for four years until a new experience study is done. An exception was made that resulted from discussion with Ms. Thompson and this committee last year. Because the valuations were developing what are called losses for rehires (liabilities greater than what Conduent expected them to be), they decided to make an adjustment for rehires in this valuation, rather than wait a couple of years until the next experience study is done to make an adjustment then. The reason for losses for rehires is that people who were once members of either PERS or TRS return to employment and have more liability (larger benefits) because they have some past service associated with their previous employment that Conduent was not anticipating.

MR. KERSHNER said that for the period from last year to this year, PERS had an additional $40 million of liabilities from the rehire assumption, and TRS had an additional $9 million of liabilities. Conduent looked at the five-year period through 6/30/15 and calculated an average loss that was occurring, expressed as a percentage of liabilities. They then developed an increase in the normal cost (the cost of benefits that is accruing in the current year for current active plan members for an additional year of service and additional pay increases) to account for the rehire losses that were occurring year after year after year. That increase in normal cost accounts for the rehires that they know are coming but cannot be anticipated because nobody knows who they are. That resulted in higher contribution rates than would otherwise have been the case.

MS. ERCHINGER thanked Conduent for making this change and GRS for following through on the rehire losses. Every time persistent issues are identified and corrected, it gives her, as a trustee, better comfort that everyone is doing the best they can and not ignoring the issues.

MR. LANGER reviewed some preliminary key observations from the FY2016 valuations. Valuations are based upon a lot of assumptions, and Conduent redoes the valuations every year because they know those assumptions are not all going to come true. To the extent that the assumptions do not come true from year to year, there are adjustments in the figures they develop.

MR. LANGER said that, during the fiscal year ended June 30, 2016, the investment return was around zero percent, which was less than the assumed return of 8.0%. As a result, there was upward pressure on the costs and downward pressure on the funded status of the plans. The zero percent return is not a bad thing or a good thing: Conduent leaves it to investment professionals to talk about how that zero percent stacks up.

Another significant event that caused an impact was lower post-retirement pension adjustments (PRPAs) than expected during that period.

Retiree medical claims were less than expected, despite liabilities being larger in the end.

ACTING CHAIR HARBO commented that almost 70% of the defined benefit retirees in PERS and TRS are covered by Medicare. Aetna medical coverage is secondary, so the retiree medical claims cost should be going down for those people.

MS. BISSETT explained that when Conduent did the per capita claim work last year they had expected an increase in claims of almost 7.5%. That has to do with the valuation trend assumptions that are in place, which are probably due to get updated at the experience study. Conduent uses a four-year rolling average for claims costs, which included some older data under the prior administrator, so they expected some gains from that older data dropping out of the rolling average calculation. Looking at FY2016 alone, she expected the trend would be 3%-3.5%. There are other offsetting pieces, the main one being the aging retiree population issue.

MR. LANGER stated that a less significant but still material impact on the valuations was salary increases being less than expected in the year. That puts downward pressure on the contributions. Lastly, there were more deaths than expected.

MR. KERSHNER reviewed a couple of slides that illustrated the movement in the funded ratios and contributions for the PERS and TRS defined benefit (DB) plans and the two defined contribution plans from 2015 to 2016. In both PERS and TRS on the defined benefit side the funded ratio went down slightly. While the market return on investments for FY2016 was roughly zero, Conduent uses a smoothed asset method that tries to eliminate the fluctuations in the financial market from year to year. The return on the actuarial value of assets (the smoothed value) was 5%, rather than zero percent, because they brought in the market gains and losses over a five-year period. If they had used the market return in the calculation, the funded ratios would be much lower for 2016. Without smoothing, the PERS defined benefit funded ratio would have been 70% instead of 77.1%, and the TRS DB plan funded ratio would have been 75.4% instead of 82.8%.

MS. ERCHINGER remarked that if former trustee Martin Pihl were sitting at the table he would say “I told you so,” as it relates to returning back to smoothing.

On the PERS and TRS defined contribution (DCR) plans, MR. KERSHNER pointed out that the liabilities are not very significant, especially on TRS, and the valuation assets, which are an accumulation of amounts that have been contributed since 2006, have clearly grown faster than the liabilities. The DCR healthcare side has more normal funded ratios. The funded ratios went up. There was discussion earlier about the allocation method on the actuarial value of assets between peace officer/firefighter and all Others. The PERS and TRS DCR total funded ratios are over 100% (but, again, these are on an actuarial value of assets basis). For example, the PERS total funded ratio of 112.9% would be about 107% on a market value basis. The TRS total funded ratio of 130.6% would be about 124% on a market value basis.

MS. ERCHINGER said she was curious about people who are in the defined contribution plan and leave early without being vested in the employer contributions and they lose those contributions, whether those contributions remain in the plan and, therefore, over time increase the funded ratio.

MR. KERSHNER responded that any non-vested employer contributions stay in the plan to be used for future benefits for other members.

MS. ERCHINGER said that sort of made sense on the healthcare side, but she did not know why that would be so on the pension side, because those benefits would not be given to other defined contribution plan members.

MR. KERSHNER again responded that the contributions are being made to the plan as a whole and not for individual members. So, if an individual member leaves before being vested, and money has been contributed by the employer and by the State for those benefits that could have been paid in the future, to the extent that that member is gone, those contributions remain in the plan to then be paid for all benefits for all remaining members and future members that might come into the plan.

MS. THOMPSON clarified that they were discussing Occupational Death & Disability benefits and not pension benefits.

Regarding the forfeiture of non-vested employer contributions, MR. WORLEY provided an example of an employer contributing $10,000 but the member is only in the plan for three years. That means the member is 50% vested, so the Division of Retirement & Benefits would only refund 50% of the employer contribution to the member when they terminated. The other 50% goes into a forfeiture account. DRB has submitted a voluntary compliance plan with the Internal Revenue Service so that employers can be allowed to use that money to offset employer contributions to the DCR __________ only. It has been about six months since DRB submitted the plan to the IRS, and they have been told it could be up to a year before they get a ruling.

ACTING CHAIR HARBO asked about the amount of money in the forfeiture account. MR. WORLEY said he could provide the numbers tomorrow.

COMMISSIONER FISHER inquired if the DRB maintains a forfeiture account per employer, and that employer would benefit from the amount in the account.

MR. WORLEY said yes. He added that if an employer had only DCR employees and was submitting a payroll, they could leave off the employer match piece and use the forfeiture funds until such time as the account was liquidated.

MR. KERSHNER next presented the preliminary FY2018 and FY2019 contribution rates for PERS and TRS employers, which are derived from the assets and liabilities that were

discussed earlier. The PERS FY2019 contribution rate of 28.53% rose from 25.01% in FY2018. The increase is a combination of the liabilities increasing or decreasing from what the actuary expected, the assets not earning what was expected, and the effect of that on the past service rate, and the rehire assumption load built into the contributions. The TRS FY2019 contribution rate of 30.45% increased from the FY2018 rate of 26.78%. The defined benefit plans and the DCR rates are then subject to the 22% employer cap for PERS and 12.56% employer cap for TRS, and the State would pay the excess contribution.

MR. KERSHNER presented a chart of the liability gain/loss on the PERS and TRS defined benefit plans for the FY2016 valuations *(slide 11)*. The chart listed all the sources of the gains and losses on the liability side, broken out between pension and healthcare. He pointed out that the two biggest items on the pension side are the COLA/PRPA increases and the salary increases. Conduent's assumptions for both the COLA/PRPA and salary increases include an inflation component, which is 3.12%. Relative to the post-retirement pension adjustment (PRPA), the Alaska Consumer Price Index that is used to generate the PRPA increases for people who are currently in payment was somewhere closer to 1%, so about one-third of what Conduent was assuming. That is why the gains are much bigger than the committee has normally seen in the past. Similarly, Conduent assumed a salary increase of basically the 3.12% inflation and a 50-basis-point merit or productivity increase, so a total of 3.62%. To the extent that, on average, the salaries for people continuing in the plans from last year did not go up by 3.62%, then there is a gain to the plan. The other major component on the liability gain/loss chart is the medical claims experience, which Ms. Bissett explained earlier.

MR. JOHNSON asked for a brief explanation of the top reasons for the loss from medical claims experience.

MR. LANGER noted that actuaries put losses in negatives, and a loss means the liability came in higher than anticipated. So, for PERS, the liability came in at $198 million higher, due to the medical claims experience. For TRS it came in $24 million less.

MS. BISSETT explained that the fiscal year 2016 medical claims came in a bit lower than expected. But there was the adjusting piece for getting rid of the dual coverage, which was nearly offset by removing those people from the data. The main piece that comes in is that when Conduent got the real retiree health plan enrollment data, people in the plan were younger than Conduent thought, so they are in the plan for another year to a year and a half, and that creates a bit of a loss. It affected PERS more than TRS because TRS got more of a benefit from removing the dual coverage.

MR. LANGER clarified that Conduent gets the dates of birth and knows how old plan members are. When Conduent removed all the dual coverage people, the ages of the *remaining* people were younger, which means they will collect the benefits longer.

MR. WILLIAMS remarked that he was glad at least one assumption came up heads for the retirement plans, because, if both the use of real data versus proxy data and the adjustment

of dual coverage had resulted in losses, the plans could have been down something like $380 million.

COMMISSIONER FISHER said Mr. Williams raised a good question of whether this was truly random and it could have been two losses. Or is there an argument that it just took time to get through the process, and the proxy data was a very close representation of the real enrollment data and better than everybody thought?

MS. BISSETT stated that she felt more confident in the results now, knowing that she is looking at the actual retiree medical enrollment data. When Conduent had the proxy data, the way some of the counts happened to pop out resulted in them becoming offsetting pieces, but not for the exact right reason that things were as close as they were.

MS. THOMPSON said that the outcome on the valuations was not random because there was no dual coverage assumption. No one knew there were so many married members in the Alaska plans that had dual coverage. There were 9,000, which is a lot of dual coverage. It was a missed assumption that she did not think anyone would know to set. She recalled that GRS had started pushing on the use of proxy data years ago, and Buck could not get the actual enrollment data from the health vendor. It has taken a while to get to the Aetna data warehouse.

Referring to the DB liability gain/loss chart, ACTING CHAIR HARBO asked what "mortality inactives" represented.

MR. KERSHNER said that demographic experience is capturing the effect on the liabilities due to the changes in the inactive group from last year to this year. Inactives are members who are currently receiving a benefit or have left employment and will be receiving a benefit when they retire. Conduent makes an assumption about how many people are going to die in the next year, and "mortality inactives" captures the people who actually did die and compares the two numbers.

MR. WEST cited Conduent's report that actual medical claims were down in FY2016 from their expectations. He asked what percentage increase the actuary was factoring in for actual claims.

MS. BISSETT replied that when she did the new projection for this one per capita claims cost year she was looking at it a little bit lower for the short-term year. The valuation trend assumptions had assumed an increase in the composite of about 7.5%.

MR. WEST asked if that was the trend over the last few years. He added that many healthcare actuaries have turned their estimates up fairly substantially since ObamaCare was enacted.

MS. BISSETT said the medical claims cost trend has been going down a little bit at a time. There are some factors for the Alaska plans, such as the change in third-party administrator.

Conduent was trying to factor in what they thought that discount was going to be based on some of the old experience, and it turned out it was better. They also learned that pharmacy rebates were reported in a different place, so now they are able to bring some of the rebate information into the assumption, which reduces the projection for per capita claims costs. While Conduent had observed a cyclical downturn, they decided to hold the valuation trend assumptions steady because they knew there were also some pharmacy claims that were spiking, not only in the industry but in the Alaska group. They saw that again in FY2016.

MS. BISSETT said that in FY2016 the pre-65 medical was favorable to what Conduent expected, but the Medicare and the pharmacy were higher than they expected.

Regarding the schedule, MS. ERCHINGER said she noticed that the committee got the draft valuation reports considerably later than last year. She asked if something in the process changed and if the committee could expect that the timing is going to be like this going forward.

MR. LANGER agreed that there are some things that Conduent has been behind on, compared to the timeline calendar. They are striving to be on time, but their focus was making sure that the reports were right and incorporated a back-and-forth dialogue with GRS. Baking in the new information for the healthcare plan took some effort to grind through as well. He added that they intend to get back on schedule. There is a slippery slope in the calendar that if they miss the middle of December as a target, many people are off work the last two weeks of the year, and it slips into January, which he wants to avoid. However, if the choice is between being on time and a report that they are reasonably confident is done, they will err on the latter. He concluded by saying the quick answer is that they will be timely next year.

MS. ERCHINGER responded that Conduent's product is definitely improved by the better coordination with the review actuary, and she is grateful for that. Her concern is more about the deadlines with the upcoming experience analysis and not getting behind as it relates to that process.

MR. LANGER stated that their people were getting queued up to start looking at that, even before they have collected all the data.

MR. KERSHNER returned to the question of contributing the normal cost as a minimum, which was discussed earlier, to get clarity on whether the committee had made a decision.

MS. THOMPSON said she had interpreted the discussion to say that the ARMB is protected under statute that the normal cost minimum is met, as Mr. Worley explained earlier, and that it was not necessary to institute a change in the funding policy.

MR. WORLEY said he understood the question to be about the past service liability being negative.

MR. KERSHNER said he wanted to tie that down so Conduent can issue the reports accordingly. It is more the defined contribution plans that it affects.

MS. THOMPSON remarked that, since the funded ratio for TRS DCR pension is 17301%, it is not a pressing problem. As the review actuary, she deferred to Conduent, but said the question of contributing at least the normal cost needs to be addressed, and that discussion could be part of the experience study.

MR. LANGER said he concurred with that: this is one of many things to look at with regard to the funding policy.

C. Review Actuary Update

MS. THOMPSON stated that she had just received the preliminary valuation reports from Conduent and had done a first run through them, so she did not have a review to report today. She did, however, want to share some of the topics she is looking at.

One thing the committee had asked her to be very sure about was working on the language in the valuation report dealing with what really is the funding policy of the ARMB versus what the statutory constraints are that have been applied against that funding policy. All of that language is there so far in the reports that she has reviewed.

MS. THOMPSON said she always reviews particularly the state allocation as it could be affected by the rehire assumption, because the rehire assumption enters through normal cost (which is a direct, “pay-for-it-this-year” cost). So far, that is looking good.

One of the puzzles this year that she did not have an answer to was why there continues to be losses on termination (meaning people are not leaving) when there are so many rehires again this year.

COMMISSIONER FISHER stated that the Alaska economy is shrinking, so the not-leaving is a current event because there are not as many other opportunities for people to go to. At the same time, people who left government employment some time ago are finding the State as an employer that is available.

MS. THOMPSON said that information was helpful. She added that Conduent provides a matrix that tracks people, where she noticed there were a lot of rehires than came back from active, but also from deferred vested status.

MR. BRICE offered that there is a substantial number of Department of Transportation employees who track the summer construction season, who go in and out of layoff status fairly regularly. That flow should be fairly consistent though.

MS. THOMPSON said she is also working at understanding the healthcare losses. A big question that she has not yet posted to Conduent is that in the defined contribution plans the Employer Group Waiver Program that will be implemented 01/01/18 has a massive gain in

it. When a plan sponsor has a Medicare Retiree Drug Subsidy (RDS), there is X amount of a subsidy. But there is three times the subsidy when there is an Employer Group Waiver Program. That is a lot more money, so, as an actuary, she would expect a gain.

MS. THOMPSON said her concern, with budget reconciliation and the fact that the Employer Group Waiver Program subsidy is supposed to sunset in 2020, is if Conduent is assuming the subsidy is going on in perpetuity or if they have sunsetted it in 2020.

MS. BISSETT said they had not sunsetted it. She has tried to gather some data from other colleagues, and there is not enough information out there yet to say one way or the other. It could go either way. Right now, Conduent has just the one-time adjustment saying that in 2018 it will increase, and then it is regular trend from there.

MR. BRICE asked if the Employer Group Waiver Program was an Aetna thing or a Department of Administration thing.

COMMISSIONER FISHER replied that it is a federal program that the retiree health plan is engaged in.

MS. THOMPSON remarked that nobody knows what is going to happen with ObamaCare. So, when she has a decision to make, she wants to be conservative. Maybe that is a reason, when looking at the normal cost contribution issue, to make sure to always contribute the minimum – TRS DCR pension might be 17000% funded right now, but that could quickly change, because these are small dollar numbers. The Employer Group Waiver Program is only in the defined contribution plans.

MS. BISSETT explained that she only put the Employer Group Waiver Program (EGWP) in the DCR valuations because it is part of the SPD that they are going to plan to go to EGWP on 01/01/18 as practically possible. She had not yet put anything into the defined benefit plans because she understood that it would need to be announced, adopted and approved.

COMMISSIONER FISHER stated that in the retiree health plan 45% of the expenses are pharmaceutical because the medical is secondary to Medicare. The EGWP has the potential of being a fairly impactful enhancement, reducing the unfunded liability on the healthcare. That gets back to the discussion about how to allocate money between pension and healthcare.

MS. THOMPSON said that congressional budget reconciliation is the method by which some of the funding of some of the new administration's work needs to be done. Budget reconciliation could impact the Affordable Care Act. Congress could dial away the Cadillac tax in budget reconciliation by just turning the tax dial, without taking it to a vote. Maybe the subsidies that come out of CMS (Centers for Medicare and Medicaid Services) could be something else too. There is enough uncertainty just to err on the side of caution. As the auditing actuary, she would talk to Conduent about it and put it into her report.

MS. THOMPSON stated that she planned to talk to Conduent about the Getzen model because they do not converge to long-term growth in the GDP (gross domestic product). She and Ms. Bissett have talked about that in front of the Board before – Ms. Bissett believes that medical will still have costs long term above GDP growth, while she wonders how that could be because then the U.S. becomes a country that provides healthcare. That is an ongoing and interesting debate.

COMMISSIONER FISHER voiced his understanding that, if Conduent accepted GRS's view, it would actually result in a savings to the retirement plans.

MS. THOMPSON stated that when she receives the valuation reports she looks right away at the mortality gain/loss because she is expecting that the retirement plans need to go to fully generational mortality tables. Yet this year they showed large gains on mortality again, meaning people are dying faster, which means the table is adequately covering for the last year. That does not mean the plans will not go to generational mortality, which would create a cost, but it is something she will continue to monitor.

MS. THOMPSON reported that she has been reviewing the minutiae of test lives with Conduent on the phone and getting all of that resolved.

D. Committee Manual Update

MS. THOMPSON stated that she incorporated a number of comments from the committee's review of the proposed Actuarial Committee Best Practices Manual at the December meeting. Those changes fell into two major areas: making sure to interject the legislative constraints so that readers understand what the law is and where the committee can be flexible; and adding a number of historical tables. One table is a history of the Board-approved contribution rates, and another is the historical rates of return for the PERS and TRS trust funds. On page 34, following up on the historical returns, she decided to put in a table of what the major assumptions looked like in the different economic environments.

MS. THOMPSON said the main body of the manual is intended to be fairly concrete and not change much, but the appendices will talk about changes that affect the valuation and actuarial processes.

MS. ERCHINGER commented that Ms. Thompson had done a great editing job since the December meeting, where there were quite a few comments and different ideas on how things should be structured. She felt that someone could read the manual and get a very good sense of where the Actuarial Committee is and how it got here. She thanked everyone for providing their comments to Ms. Thompson, and Ms. Thompson and her staff for pulling it all together after the December meeting.

COMMISSIONER FISHER apologized for missing the last two meetings because of a conflict with Permanent Fund meetings. He recently reviewed the proposed Best Practices Manual and had two broad concerns. One is that, in an effort to provide some of the

historical context, there are statements that the Board may have preferred funding practices that run counter to those in the statute, and that the Board has expressed a preference for the level dollar method to be used in developing annual amortization payment amounts. He said the document is coming into a context that is charged. There is an ongoing debate between the municipalities and the legislature, and the whole question about level dollar versus percent of pay sort of happened in a context that is still playing out. He said he was concerned that the document, as currently drafted, feels like the committee is taking sides in that debate. Even though individual trustees may take sides in that debate, he did not think that the Board should. He said the committee should be very careful about something that the legislature could construe as the committee taking sides or instructing them on proper practices, because there is a risk that it could impact the ARMB.

COMMISSIONER FISHER prefaced his next statement by saying he was speaking more as a commissioner than as an ARMB trustee. He said the proposed Best Practices Manual has been prepared by GRS without any input from either Conduent or from staff and is being created in a vacuum. The statute says that this is a dual responsibility, and the ARMB is to coordinate with the staff. He said he was puzzled about how this document is expected to inform and guide the work that staff does.

ACTING CHAIR HARBO stated that the proposed manual is meant to be a help to the new trustees and to anyone coming onto the Actuarial Committee.

MR. JOHNSON said that with respect to the commissioner's comments, obviously, staff input would come from the commissioner and be very much appreciated. Regarding GRS developing the proposed manual, he recalled that there was a specific determination that this was not an effort that the committee wanted to expend trust funds on. It was not meant to exclude Conduent or any good ideas coming from anyone. He said he agreed with the commissioner's comments respecting how to describe legislation in the manual. The committee probably does not want to advance a notion about how the Board would have written the legislation differently at times. However, there is at least one point where the legislature had a couple of statements of intent. One of the legislative statements of intent was recommended by Buck Consultants and others that the ARMB, with all due respect, declined to go forward with that expression of intent and went in a different direction. Assuming that that is the case, it should simply be stated as a fact in the manual.

COMMISSIONER FISHER said he thought Mr. Johnson was referring to the use of smoothing. He thought the legislative intent not to smooth was to sort of mark to market the trust funds, but it did not necessarily opine one way or the other on whether to smooth going forward. For himself, he would be uncomfortable representing that he just ignored the legislature, but he did get comfortable about what their intent was.

MR. JOHNSON said that on that score he felt that if it was not necessary to suggest a disagreement with the legislature, that there was no reason to advance an argument like that. At the end of the day, the legislature is going to be able to give direction on significant portions of the whole process. He noted that the proposed manual is for the Actuarial

Committee as opposed to the Board. He had some editorial comments he would provide in writing. One example is the statement on page 1 that all committee recommendations shall be approved by the Board. That sounds sort of presumptuous, and an alternative could be that committee recommendations shall be presented for, and considered for, approval by the Board. Another statement on page 3 says that neither the State nor the Board has adopted a formal written funding policy. He thought that sounded like something an auditor would tell the ARMB. He was not sure it was a good idea or a bad idea that the Board have a formal written funding policy, and he was not sure why the manual needed to make that statement, because it sounds like the Board should be doing something. On page 4 of the manual, under contribution rates – employer, member and state assistance, he thought the language needed to be refined a bit better. For example, it says that contribution rates are set in statute. The employee contribution rates are in statute, but the ARMB sets the contribution rates. That leads to another statement that suggests that the Board *recommends* contribution rates. The correct statement is that the Board *sets* the contribution rates, or use whatever verb is in the resolutions that the Board passes annually on contribution rates.

MS. ERCHINGER stated that her recollection was the same as Mr. Johnson's with respect to Buck. To her knowledge, Buck was not asked not to comment; the committee simple decided to be better stewards of the funds and not pay two actuaries to do the same work. So, to the extent that Conduent (Buck) has any comments and they want to review the proposed manual without charging the ARMB, then they are welcome to do that. It was not meant to exclude them from the conversation.

MS. ERCHINGER said that, with respect to the comments regarding the issues between the municipalities and the State, in her opinion that has nothing to do with the conversation. From a political perspective, it may, but as a trustee she thought the issue has been and continues to be that the ARMB's charge is to make sure that the retirement funds are fully funded for the benefit of the beneficiaries. The Board, in the past, has made recommendations in order to accomplish that. Those recommendations are things that the members of the legislature, who have the power to pay contributions, will either pay or not, based on the resources available. But she did not want to get into a conversation about who pays the bill. Only that the Board has gone on record in the past as strongly favoring level dollar, not for political reasons because trustees take one side or another in terms of municipalities or the State, but because they recognize the significant savings by getting contributions into the plans earlier, and she thought because the trustees recognize that the State and the municipalities may not have the money in the future to pay what is being pushed off onto future generations. She respected the job that trustees of the retirement plans have to do versus the job that the legislature has to do to figure out how to balance the needs of all the competing interests on the state budget. But she did not think that it is fair that the committee cannot say that the actuarial methods being used are not the ones that trustees would support if they had the capacity to make that choice. Prior to the most recent legislation, the ARMB did set the contribution rates. Responding to Mr. Johnson's comment that only the employee contribution rates are set in statute, she did not necessarily agree with that, now that legislation mandates the actuarial method and the amortization period. By its nature, if the committee knows what the unfunded liability is, and the Board is mandated to

go with a particular actuarial method and a particular actuarial period, the end result of that is a contribution rate that the committee is asked to approve and recommend to the Board for approval. It is somewhat semantics as to whether or not the contribution rates are set in statute.

MS. ERCHINGER stated that the commissioner is a valued member of the Actuarial Committee and his opinions are valued. She encouraged him to bring forth his comments. The committee has had some robust discussions about exactly some of the issues that the commissioner has brought forward, and there is not consensus on a lot of the issues. The committee is trying its best to come up with a manual that reflects the consensus opinion of the committee. The manual is a big work in progress, and it will take a while to nail down what committee members want the end result to be.

COMMISSIONER FISHER said he wears two hats but is on the committee as a trustee. He said he would review the manual further. He said he agreed one hundred percent that the Board and the trustees have an obligation to ensure that the retirement funds are adequately funded. The largest single event in the last decade to address that was the $3 billion that the legislature allocated to the retirement funds, and they did it in a particular way, and it had certain implications. He, personally, was a little uncomfortable saying thank you for the $3 billion on the one hand and then being critical of the other decisions the legislature made that were part and parcel of that deal. He does not have a conversation with a municipality that they do not bring up the issue of the increased amortization and the way the retirement trusts are funded. The committee is not stepping into a conversation that is a blank sheet of paper. There is history, and the committee should be careful that it is not perceived as picking sides in a fight.

MS. HALL asked committee members to send any suggested language revisions through her and she would work with Ms. Thompson on the next draft, which will show any new suggested language in highlights.

MR. WILLIAMS stated that it made sense that the manual not give the appearance that the committee is crafting an adversarial relationship with other entities. The ARMB has had level dollar before and has used the percent of pay method before. The manual could include a neutral narrative on the philosophies behind the two methodologies, and include the legislature's intent language. He said that as a new trustee he found a lot of the history and prior issues to be very informative and useful. He also had the recollection that the committee considered the cost savings when choosing GRS to prepare the manual and did not want to pay Conduent at the same time. The committee wants as much input as possible and also wants a document that is as informative as possible, but without any appearance of an adversarial relationship with others.

ACTING CHAIR HARBO asked members to forward their comments to Ms. Hall. The committee would take up the revised draft of the manual again at the next meeting.

VIII. FUTURE MEETINGS

A. Calendar Review

MS. ERCHINGER asked if a review of the Actuarial Committee Charter could be added to the October 4, 2017 agenda.

MS. HALL informed members that the April 19 committee meeting has a very long agenda because the committee will be discussing the current valuation reports, hearing the GRS reviewing audit report, and doing some planning for the experience study. It could be an all-day meeting.

MR. WILLIAMS asked for consideration to hold committee meetings that do not conflict with the State Board of Education meetings, because his new role requires him to be at those meetings.

MS. ERCHINGER mentioned that there are a few specific items on the April 19 agenda that she would like members to give some thought to before the meeting. One specifically is to discuss whether administrative expenses should continue to be netted out in the investment returns or ask the actuaries to consider adding an explicit assumption for administrative expenses into the costs when setting the rates. Another topic to think about is how to incorporate, if at all, Alaska-specific trends, such as declining payroll, declining populations, and the payroll growth assumptions given the Alaska economy and the future.

ACTING CHAIR HARBO advised fellow members of an 8-page paper put out by the National Association of State Retirement Associations that might be helpful in terms of looking at the experience study. The title is "Public Pension Plan Investment Returns," dated February 2017, and is available online at NASRA.org.

MS. ERCHINGER thanked Ms. Harbo for chairing this meeting while she was away.

B. Agenda Items

There were none.

C. Requests/Follow-Up

There were none.

IX. Adjournment

The meeting adjourned at 4:00 p.m., on a motion by Mr. Williams and seconded by Mr. Johnson.

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

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