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

**Hotel Captain Cook - Club Room II**
**939 West 5th Avenue**
**Anchorage, Alaska**

**June 21, 2017**

## ATTENDANCE

**Committee Present:** Kristin Erchinger, *chair*
Tom Brice
Commissioner Sheldon Fisher
Gayle Harbo
Rob Johnson
Norman West

**Committee Absent:** Bob Williams (out of town)

**Department of Revenue Staff Present:**
Pamela Leary (Treasury Division director)
Bob Mitchell (chief investment officer)
Zach Hanna (state investment officer)
Stephanie Alexander (board liaison officer)

**Department of Administration Staff Present:**
Ajay Desai (director, Division of Retirement & Benefits)
Kevin Worley (chief finance officer, Division of Retirement & Benefits)
Kathy Lea (chief pension officer, Division of Retirement & Benefits)
Emily Ricci (chief health policy administrator, Division of Retirement & Benefits)
Michele Michaud (deputy director, Division of Retirement & Benefits) *by telephone*

**Others Present:**
Melissa Bissett (Conduent, actuary)
David Kershner (Conduent, actuary)
Leslie Thompson (Gabriel Roeder Smith & Company, review actuary)
Paul Erlendson (Callan Associates)

## I. CALL TO ORDER

CHAIR KRIS ERCHINGER called the meeting to order at 11:47 a.m.

## II. ROLL CALL

Six committee members were present at roll call to form a quorum.

## III. PUBLIC MEETING NOTICE

MS. ALEXANDER confirmed that public meeting notice requirements had been met.

## IV. APPROVAL OF AGENDA

Approval of the agenda was moved and seconded. The motion passed without objection.

## V. PUBLIC/MEMBER PARTICIPATION, COMMUNICATIONS AND APPEARANCES

There were no members of the public present at the meeting site, and there was no public comment made by telephone.

## VI. APPROVAL OF MINUTES – April 19, 2017

MR. WEST moved to approve the minutes of the April 19, 2017 meeting. MS. HARBO seconded. The minutes were approved without objection.

## VII. ACTUARIAL REVIEW/AUDIT FINDINGS LIST UPDATE/CERTIFICATION AND ACCEPTANCE OF FY2016 VALUATIONS AND AUDIT REPORTS

### A. Introduction

CHAIR ERCHINGER talked briefly about the committee's path in systematically working its way through the list of audit findings from the review actuary and reaching resolution on many of those findings over time.

### B. Gabriel Roeder Smith Review

#### 1. FY2016 Judicial Retirement System and National Guard Naval Militia Retirement System Valuations

LESLIE THOMPSON, senior consultant with Gabriel, Roeder, Smith & Company (GRS), the review actuary, gave a report on the actuarial review of the June 30, 2016 valuations that her firm performed for the Judicial Retirement System (JRS) pension and health plans and the National Guard and Naval Militia Retirement System (NGNMRS) pension and health plans. *[GRS's written report, dated June 9, 2017, was provided to the committee members in advance of the meeting and is available at the ARMB office.]*

MS. THOMPSON spent some time explaining GRS's in-depth analysis of the test lives data for JRS and NGNMRS that they received from Conduent (formerly Buck Consultants). The written report included exhibits that summarized that analysis and also provided a comparison of the test life results between Conduent and GRS. The test cases that GRS completed were a close match with those that Conduent provided. GRS had no new findings on the test cases for the June 30, 2016 audits of JRS and NGNMRS.

MS. THOMPSON reviewed the GRS findings from their audits of the fiscal year 2016 valuations, which are summarized in the Executive Summary in section 1 of the GRS written report.

2. **Update: DB and DCR Valuations Previously Reviewed**

MS. THOMPSON provided an update on the Public Employees' Retirement System (PERS) and Teachers' Retirement System (TRS) defined benefit plan and defined contribution plan actuarial valuations previously reviewed.

## C. Audit Findings List – Updated from April 20, 2017

MS. THOMPSON commented next on the one-page updated GRS Actuarial Audit Findings spreadsheet for PERS and TRS defined contribution plans, which included the GRS recommendation for each issue, Conduent's comments and response, and the action that had been taken or was ongoing.

The second two-page Actuarial Audit Findings spreadsheet listed issues in the PERS and TRS DCR plans related to GRS's 2017 experience analysis review. MS. THOMPSON highlighted several of the issues on the list and explained Conduent's responses to the GRS recommendations and whether an issue had been resolved or was still being discussed.

## D. Action Items:

1. **Committee Recommendation for Board Acceptance of GRS Certification for FY16 PERS, TRS, NGNMRS, JRS and DCR Plan Actuarial Valuations**

The committee reviewed a June 21, 2017 staff memorandum summarizing the work of the ARMB's review actuary on the actuarial valuations of various retirement systems as of June 30, 2016, which the Board's primary actuary, Conduent Human Resource Services, had conducted.

<u>MS. HARBO moved that the Actuarial Committee recommend that the Alaska Retirement Management Board accept the review and certification of FY2016 actuarial reports by Gabriel Roeder Smith & Company</u>. <u>MR. JOHNSON seconded</u>.

The motion passed unanimously, with trustees West, Johnson, Harbo, Fisher, Brice, and Erchinger voting in the affirmative.

2. **Committee Recommendation for Board Acceptance of Conduent FY16 Actuarial Valuations for PERS, TRS, NGNMRS, JRS and DCR Plan**

The committee reviewed a June 21, 2017 staff memorandum that described the actuarial valuations of a list of retirement systems as of June 30, 2016 that the ARMB's actuary, Conduent Human Resource Services, had performed. The committee had received detailed progress reports from Conduent on the valuations at its March 1, April 19, and June 21 meetings. It was noted that Conduent was not recommending any changes to the current actuarial assumptions used in the valuation reports. They would be conducting a new experience analysis in 2018 and bringing recommendations on the actuarial assumptions to the committee and the full Board through that process.

MS. HARBO moved that the Actuarial Committee recommend that the Alaska Retirement Management Board accept the actuarial valuation reports prepared by Conduent Human Resource Services for the Public Employees', Teachers', Public Employees' Defined Contribution (for Occupational Death and Disability and Retiree Medical Benefits), Teachers' Defined Contribution (for Occupational Death and Disability and Retiree Medical Benefits), Judicial Retirement System, and National Guard and Naval Militia Retirement System, as of June 30, 2016. MR. BRICE seconded.

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

CHAIR ERCHINGER called a recess for lunch at 12:15 p.m. and reconvened the meeting at 1:35 p.m.

## VIII. ECONOMIC ASSUMPTION SETTING – EXPERIENCE ANALYSIS

CHAIR ERCHINGER announced that Larry Langer was no longer with Conduent, but she thanked him for the work he had done for the committee. DAVID KERSHNER of Conduent added that David Driscoll, the head of their public-sector consulting practice, would be joining the team working for the ARMB.

MR. KERSHNER referred to Conduent's slide presentation entitled "State of Alaska Retirement Systems - 2018 Experience Review: Background on Setting Economic Assumptions - Presentation to the Actuarial Committee," dated June 21, 2017 *[on file at the ARMB office]*. He noted that a prior presentation on the valuation process showed a variety of inputs and outputs. Actuarial assumptions are one of the inputs and are predominantly the subject of the experience study. Conduent will also consider recommended changes in funding methodology, such as normal cost as a minimum or adding administrative expenses as an explicit part of the contribution. While the other inputs to the valuation process – membership data, assets, and sometimes the benefit provisions – change every year, generally the assumptions and the funding methodology are set and not changed every year.

Experience Review Process:
MR. KERSHNER said the purpose of economic assumptions is to try to estimate what may happen in the future, based on what has happened recently, and how those things are expected to change going forward – because the valuation process is to project benefit payments and contributions for many years in the future.

The Alaska Retirement Management Board (ARMB) undertakes an experience review every four years. The last experience study was finalized in 2014 and was used starting with the 6/30/14 valuations. The new experience review will study the experience starting 7/1/13 through 6/30/17, and those assumptions will be used beginning with the 6/30/18 valuations.

MR. KERSHNER said the goal of each assumption is to be the best estimate of future experience, looking at past experience for guidance, but the past may not necessarily be indicative of what they expect for the future. The committee and the Board have a fiduciary responsibility to ensure that there is sufficient assets to pay promised benefits. If there is a range of assumptions, Conduent generally builds in some level of conservatism because they would rather err on the high side and put more money into the retirement systems than be short. Lastly, setting assumptions is very heavy on calculations, but there is also an art to it.

MR. KERSHNER listed all the areas that would be included in the experience review. He indicated that the economic assumptions of inflation, investment return, salary scale, payroll growth, and post-retirement pension adjustments were the focus of today's discussion. Healthcare economic assumptions will be presented at an upcoming meeting. Demographic assumptions will also be taken up at a separate meeting.

<u>Setting Economic Assumptions</u>:
MR. KERSHNER explained that Conduent was bridging the gap between what they know today and what they think may happen in the future to then establish a series of projected cashflows, which are then discounted using the investment return assumption (currently 8.0%), to determine the present value of liabilities. Even though the PERS and TRS defined benefit plans were closed to new members in 2006, the objective is to take a very long-term view when setting the assumptions because some members are still in their thirties. However, they still factor in some short-term situations.

MR. KERSHNER spent a few minutes reviewing the ASOP 27 (Actuarial Standards of Practice that provide guidance to actuaries in setting economic assumptions). *[See slide 9]* ASOP 27 was recently revised. Actuaries used to select assumptions from a "best-estimate" range. The overriding principle was to select a range over which it was more likely than not to fall. The new standard applies a "best-estimate" standard to each assumption. Each economic assumption has to be a reasonable best estimate of future experience.

MR. JOHNSON asked if it was appropriate for an actuary, for example, to select something on the far right side of the range for one economic assumption like investment return, but select something on the far left side of the range for salary, because it is assessed separately.

MR. KERSHNER said an actuary could do that, as long as common components of the economic assumptions are internally consistent. For example, the actuary could not assume that inflation would be very low for salary increase but be high for the investment return assumption.

Chief investment officer BOB MITCHELL said he assumed up to this point that the actuary would be using something akin to a median expectation for an assumption like the return estimate. He asked if Mr. Kershner would characterize the earnings assumption in the last experience study to be the median from the information available at that point.

MR. KERSHNER replied that it should have been, although he was not part of the last experience study. Using the GEMS model, they are looking at the 50$^{th}$ percentile.

MR. MITCHELL said he was trying to calibrate the impact of the new ASOP 27 on the major assumptions, like the earnings assumption. It did not sound like there was a bias that would be necessarily corrected by the change in the standard. MR. KERSHNER agreed.

MR. KERSHNER reviewed the building block method commonly used for setting assumptions. *[slides 11 & 12]*

Chief finance officer KEVIN WORLEY asked how a bargaining unit with a three-year contract that has zero percent growth on salary increases would factor into something like inflation.

MR. KERSHNER replied that a group that is known to have a three-year contract with no pay increases can be factored in. It is called a select ultimate assumption, which is known to be different than what the ultimate or long-term assumption is. He recalled a prior discussion about the TRS perhaps having a short-term salary growth assumption that is different than the long-term assumption.

MS. HARBO, referring to the chart of PERS/TRS current economic assumptions on slide 11, said she thought that 3.62% payroll growth was too high. Many teachers are at the top of their pay scale, especially in Tier I, and usually do not get a pay raise: by contract, they are given a bonus on a percentage basis.

CHAIR ERCHINGER inquired if Conduent, when projecting the payroll growth, would take into account that a certain percentage of teachers are topped out on the salary scale.

MR. KERSHNER responded that a typical career is higher salary increases in the earlier/younger years and then it starts to level off. It is common, for example, for teachers as they approach their sixties, to start reducing the salary increase assumption at a certain age or after a certain number of years.

MS. HARBO commented that this year there is 100% turnover in the teacher population in some of the bush communities. There have been over 600 non-retention slips sent to teachers in the state. Some may be rehired, but many of them will not.

CHAIR ERCHINGER said that was an important issue, in light of Alaska's unique fiscal situation and the likelihood of either reductions in force or people's pay being frozen. If 30-year projections are assuming historically consistent salary increases, the contribution rate will be based on those assumed salaries that are not there. She thought that would have a material impact.

MR. KERSHNER stated that the salary assumption for the Teachers' plan, which was set four years ago, is based on service. The annual increase assumed, which is a combination of inflation, productivity, and merit, etc., was in the 7.5% to 8.0% range in the first year and gradually decreased down to just under 3.9% after 22 years. He imagined those numbers would be lower in the next experience study, but it would probably be a similar pattern of being higher in the beginning of a teacher's career and then gradually tapering off as they get more service.

MR. BRICE asked how overstated salary and payroll growth assumptions would impact the actual value of the retirement systems and how employer contribution rates are set.

MR. KERSHNER explained that, if the assumptions are higher than real experience will show, it will generate higher liabilities on a present value basis and higher employer contribution rates. That builds in expected salary increases. Every year Conduent produces a gain/loss table that shows what they expected to occur and what actually occurred. The liabilities one year from now are lower because the actual pay increases were not quite as high as Conduent projected them to be. One reason they include that gain/loss table is because, as the review actuary has pointed out, some of the gains have been persistent gains. Conduent looks at that when they set the assumptions because they do not want to have a significant bias. If there are significant gains every year, it means an assumption is too conservative. They will still use the same assumption going forward, but their starting point will be a step lower because the pay that they are starting with a year from now is lower than what they thought it was going to be one year out.

MR. MITCHELL asked if Conduent applied a flat turnover assumption or if they adjusted it based on other characteristics, such as tenure.

MR. KERSHNER said usually age and service related, and there might be a different turnover assumption for males and females – based on the experience.

MR. KERSHNER made it clear that Conduent was not at the point of making recommendations because they had not analyzed the experience yet. He proceeded to demonstrate the type of analysis Conduent will go through when they set the assumptions. He started with the inflation assumption, where they look at the national mean inflation rate (CPI) and the Anchorage mean inflation rate over quite a few different time periods. The Anchorage measurement is particularly important because the post-retirement pension adjustment (PRPA) and the cost-of-living allowance (COLA) benefit increases are tied directly to changes in the Anchorage CPI index. Over a 50-year period, the national inflation average has been 4.1%, over 20 years it has been 2.14%, and it has been much lower over the last ten years. Conduent looks at these historical rates, but the important question is how inflation is expected to change going forward and how quickly it is expected to change. Conduent's current investment model has inflation expectations in the 2.0% to 2.5% range over the next ten years. The long-term, 30-plus years, inflation expectation reverts back closer to 3.0%, which has been the historical average.

COMMISSIONER FISHER expressed his discomfort with the inflation number that underlies some of the assumptions. For example, it is not the real return component of the investment return assumption but the inflation assumption that seems out of place. The same for the current salary increases assumption of 3.62%, where the inflation assumption is 3.12% of the total number. He said it would be helpful to see some sensitivity work that shows both halves of the equation, because if the inflation assumption is wrong, that impacts both the revenue in, the growth in assets, and the liabilities – for example, if actual inflation turns out to be lower at 2.0% or higher at 4.0%.

MR. KERSHNER pointed out that inflation also affects the benefits. He added that the trick to the analysis the commissioner was requesting is on the investment return assumption, in terms of the inflation component and the real rate of return. If the overall return is 8.0%, is that a 2.0% inflation and a 6% real return or a 3.0% inflation and a 5% real return? He did not think that was an easy thing to really measure.

COMMISSIONER FISHER said his sense was that the 4.88% real return does not feel so far out of whack.

MR. MITCHELL confirmed that that was reasonable. He asked what Conduent's time horizon was for the 8.0% investment earnings assumption with a 3.12% inflation assumption. He continued, noting Mr. Kershner's earlier statement that the model has a lower inflation assumption over a shorter period of time. He asked if that implied that the embedded returns would be lower and the real return effectively would be sort of in line with the inflation assumption over the next ten years. For example, the return might be less than 8.0% over the shorter term, and then over the longer term might be higher than 8.0%, and over a full period it would be 8.0%.

MR. KERSHNER addressed the first question, saying Conduent is generally looking at a 20 to 30-year expected return.

MR. MITCHELL said he was trying to boil it down to a present value of the funded status for each retirement plan. He asked how the differential rate over different time horizons is joining up with the liabilities to determine the present value of the assets and liabilities.

MR. KERSHNER stated that Conduent is using the model to set, in this case, an 8.0% investment earnings assumption, and they are using 8.0% in all years, even though they do not think it will probably be 8.0% in the next year or the next year. But over the long term, the average expected return is 8.0%.

MR. MITCHELL said that presumably the model would have higher returns in the out years to average 8.0%.

Regarding salaries, MS. HARBO stated that in the last five or ten years many of the bargained contracts concentrate on the employers increasing healthcare payments for the members, rather than raising salaries. That would mean a slower growth in the salary increases.

MR. JOHNSON asked if it was reasonable to assume that the same 3.12% inflation assumption number used in the investment return assumption should be arithmetically applied to the salary increases and payroll growth assumptions.

MR. KERSHNER confirmed that whatever inflation assumption is set will be the same underlying inflation assumption that is used for other assumptions, including the healthcare trend rates. That is the internally consistent piece that is required in ASOP 27.

<u>Projecting Investment Returns</u>:
MR. KERSHNER showed a graph of nominal investment returns for PERS and NGNMRS from 1991 to 2016, pointing out the mean return of around 7.0% for PERS (representing the larger plans)

and approximately 6.5% for the National Guard (which is more conservatively invested).

He also showed a slide of data from a NASRA (National Association of State Retirement Administrators) survey published in February 2017, that showed the distribution of investment return assumptions among 127 public retirement systems in the country *[slide 15]*. The graph illustrated that in the early 2000s quite a number of plans were still using 8.0%. The number of plans using an 8.0% return assumption has steadily declined, especially since 2009, until the projection for 2018 is only 19 plans (about 15% of the group). The current year projected, 83% of the 127 plans are using an investment return assumption less than 8.0%, and 17% are using 8.0% or higher. There is definitely a shift. Conduent will not necessarily set its assumption based on this information, but it is more data that they factor in.

MR. KERSHNER stated that the PRPA and COLA assumptions are directly tied to the inflation assumption. Another assumption that factors into setting of the PRPA and COLA assumptions is estimating what percentage of retirees will remain in Alaska during their retirement years to receive the COLA. Conduent cannot tell from the membership data who is a resident of Alaska and who is not, so that may be a difficult thing to analyze.

MR. KERSHNER said the investment return assumption is intended to be a long-term assumption. Conduent looks at the short-term returns, but they are not necessarily indicative of what they expect over the long term. Short-term returns are very dependent upon economic cycles. It has been a very low-interest-rate, low-inflation environment for the last several years. Interest rates are starting to creep up a little bit. In setting the investment return assumption, Conduent uses the expected rates of return by asset class. The Board will be approving a new asset allocation at this week's board meeting, and Conduent will use that new allocation in determining the overall expected return.

CHAIR ERCHINGER referred to the graph on slide 15 and asked if it was possible to see the NASRA survey public pension investment return assumptions in real return numbers instead of nominal returns. If the ARMB's inflation assumption is too high, then the retirement funds will likely hit the 8.0% investment return target. The ARMB is comparing its 8.0% return target against everyone else's rate that includes inflation. Excluding the inflation component, perhaps the ARMB is not so far off the mark.

MR. KERSHNER said he would find out if that information was available.

He explained that when Conduent has run the model they will get into more detail on what goes into the model at an upcoming meeting. They use the GEMS (General Economy and Market Simulator) model to generate projected asset returns. It is a very dynamic model using a wide range of economic and capital market conditions. The model allows for changing conditions over time, and can place a heavier weight on current conditions earlier in the forecast years (like low inflation and low interest rates). Over time, the model generally assumes that expected returns will revert to the historical averages.

MR. KERSHNER ran through several slides showing sample inputs and sample outputs using the GEMS projection model.

Experience Review Schedule:
MR. KERSHNER presented the current schedule for the experience review process, which was revised following the last meeting *[slide 26]*:

- The economic modeling discussion – today's meeting.
- 7/1/17 valuation data provided – September 1, 2017
- Healthcare discussion – October 4, 2017
- 7/1/17 valuation data completed – December 1, 2017
- Economic assumption recommendations – December 6, 2017
- Demographic assumptions – initial discussion of findings – March 28, 2018
- Assumptions finalized – June 20, 2018
- Experience review report finalized – September 1, 2018
- Assumptions implemented in 2018 valuation – October 2018 to December 2018

Regarding the discussion at the last meeting about why it takes so long to conduct the experience review, MR. KERSHNER said Conduent can try to condense the schedule. They believe, however, that it is important to look at everything in totality and then have the recommendations, rather than try to get the economic assumptions finalized early and then look at the demographic assumptions. Those components are separate but inter-related.

COMMISSIONER FISHER wondered if some of these conversations should be happening in front of the full Board. He guessed that Revenue Commissioner Hoffbeck would be very interested in some of the discussions.

MR. JOHNSON said he has had similar thoughts and has tried to draw reference to the minutes and documents from the committee meetings that are available. The Actuarial Committee is unique in that it is virtually a committee of the whole. He thought the more education that can be provided to everybody, the better. He felt the Revenue commissioner, if he was unable to attend the committee meetings, had knowledgeable staff who did attend and could keep him informed.

CHAIR ERCHINGER noted that the experience review schedule spanned a year and a half. Somewhere in that schedule there should be a presentation to the full Board to review for the record the major assumption changes being recommended. Perhaps that should occur before this committee acts to accept any recommendations so that non-committee trustees could discuss any aspects in more depth. The other alternative is to invite the two non-committee board members to the committee meetings when the economic assumptions are going to be taken up so they can avail themselves of the discussion.

MR. MITCHELL suggested the March 2018 meeting as a time to lay out the recommendations for assumption changes to the full Board. A presentation regarding assumptions will have occurred at the committee level the day before the March board meeting.

CHAIR ERCHINGER commented that this year is unique because of the full experience review. In the future, maybe that conversation should be rolled in before the Board meets to talk about the asset allocation.

MR. MITCHELL pointed out that during this cycle the asset allocation discussion will be held at the June meeting. Normally it happens at the prior meeting. Perhaps that could be done again next year, because it would give the Board an opportunity at the March meeting to go through it and there would be more visibility on the assumptions at that point.

CHAIR ERCHINGER approved of that suggestion. The committee has talked quite a bit about public perception over the 8.0% return target, but anyone from the public is more likely to listen to a board meeting than this committee meeting.

MS. THOMPSON thanked the committee for being in front and giving so much time so GRS could review the GEMS model, which was new to them, as well as the ARMB, four years ago. The building block model resulted in a different recommendation than if the GEMS model was used. That is what made that such a critical part of her discussion four years ago, and why she has continued to urge talking about both GEMS and building block. When they get numbers, if they are different, there will need to be a discussion and understanding of why they are so different. The GEMS model is not referenced in the actuarial standards of practice. That does not mean it is wrong to use it, but it probably means doing some work around understanding it and tying it back to something that is in the standards.

CHAIR ERCHINGER recalled that Callan Associates, the ARMB's general consultant, had talked to the Board about the use of GEMS, and that had added to her understanding and comfort with using it because the Board had not been exposed to it in the past.

PAUL ERLENDSON of Callan Associates said that about a year ago members of Callan's Capital Markets Group had a meeting with the ARMB's Investment Advisory Council and chief investment officer Gary Bader to talk about the GEMS model. There is not a lot of history with its use by U.S. pension funds, but larger firms are starting to use it. The model is an economic scenario simulator, so one needs to embed assumptions in the model; it is not just a black box. The most critical element is the underlying assumptions that feed into the economic scenario model in order to make sure you are getting results that are consistent with what you think is going to happen. Inflation in capital markets is a broad national inflation. But if one is a retiree living in Alaska, it is not broad economic inflation, it is the cost of goods and services, not the least of which is healthcare. As a person grows older, healthcare becomes proportionately a greater demand on the economic resources they have, versus someone who is 25 and in perfect health. He agreed with Ms. Thompson that it is a good idea to spend a lot of time thinking about this and going through the exercise to help the ARMB make informed, good decisions.

MR. JOHNSON said he did not think it was the ARMB's goal to be cutting-edge technology. He asked if there was any discomfort from the review actuary and advisor with employing the GEMS model in setting the assumptions. This is an area where the committee and the Board have to rely on the experts.

MR. ERLENDSON replied that the GEMS model is firmly supported; in fact, Callan is using it currently. However, there are a lot more assumptions and a lot more flexibility about them in an economic scenario model than there is in a standard mean variance optimizer. Callan is comfortable with the GEMS model and it is part of the way they approach asset/liability work now.

MS. THOMPSON stated that she had raised her concerns. The bulk of her concern occurred four years ago when the model could not be adequately explained. She is hopeful that this time everyone will be able to understand what is underneath the numbers.

The Chair called a break from 2:50 to 3:00 p.m.

## IX. EGWP IMPLEMENTATION

EMILY RICCI, chief health policy administrator in the Department of Retirement & Benefits, presented an overview of the Employer Group Waiver Program (EGWP). *[The slides for this presentation are on file at the ARMB office.]* She said the goal of the retiree drug program is to improve the financial efficiency of the retiree program, while making sure to minimize member impact and preserve the overall benefit value. She stressed the importance of the pharmacy plan within the Alaska retiree health plan (AlaskaCare). In calendar 2016, about $516 million was spent in medical and pharmacy claims. Forty-two percent of that (about $218 million) was actually related to the pharmacy expense, which is very high. By comparison, about the 15% of the total spend in the active health plan was related to pharmacy. The high spend on pharmacy benefits in the retiree health plan has to do specifically with the way that Medicare coordinates with the health plan. When members become Medicare eligible at age 65, Medicare pays primary for medical claims. However, the health plan continues to pay primary for pharmacy claims.

MS. RICCI explained that EGWP is one of two programs that the federal government has established for federal subsidies to support retiree health plans as a way to incentivize them to maintain prescription drug benefits. AlaskaCare already receives the Retiree Drug Subsidy (RDS) from the Centers for Medicare and Medicaid. EGWP is an alternative subsidy that the vast majority of plans are now adopting. EGWP is a way to enroll a group of retirees into a Medicare-approved Part D prescription drug plan. Individuals with Medicare Part A or Part B coverage are eligible to enroll.

MS. RICCI said that today the AlaskaCare retiree health plan receives about $19-$20 million in RDS subsidies from the federal government each year. RDS subsidies are very limited when it comes to individuals who have low or no utilization of prescription drug benefits. RDS subsidies are also capped for members who tend to use higher levels of prescription drug benefits. RDS subsidies cannot be counted against the OPEB (Other Post-Employment Benefits) liabilities for purposes of GASB.

MS. RICCI described the unique features of EGWP. It allows an employer to take advantage of EGWP through a group Medicare Part D plan and also to customize a wrap-around benefit that allows retirees to experience almost exactly the same benefit as they would outside of an EGWP program. Subsidies are also provided differently than they are for RDS. There are three streams of subsidies within the EGWP program that a health plan can be compensated for. The first subsidy is based on a type of per-enrollee base amount, and that fluctuates depending on the estimated risk for the population. Another stream involves essentially a 50% discount on brand-name drugs. When members reach spending levels that right now would be considered part of the Medicare Part D “donut hole,” the plan will receive a 50% subsidy for any brand-name drug expenses that are incurred when members are spending in that “donut hole.” The third stream of subsidy that the health plan is eligible to receive is an 80% reinsurance program for high cost utilizers.

MS. RICCI stated that EGWP subsidies are estimated to be $35 million and $45 million in net savings annually. That is $15-$23 million more to the retiree health plan than what the RDS program pays. Also, EGWP provides an immediate reduction to the OPEB liability because the funding can be counted on the GASB side.

MR. JOHNSON sought confirmation that the RDS subsidies go into the healthcare trusts. MS. RICCI said yes. She added that the EGWP subsidies would also go into the healthcare trusts.

CHAIR ERCHINGER said she did not understand why the RDS subsidy does not allow to offset against the OPEB liabilities but EGWP does allow it.

MS. BISSETT said it hinges on where the money is coming from and going to.

MR. WORLEY added that the State applies for the RDS to get the rebate, where the EGWP is part of the actual plan payment for GASB purposes.

MS. RICCI stated that EGWP is a Medicare Part D plan and subject to CMS regulations (Centers for Medicare and Medicaid). On adoption of EGWP, the health plan would be required to adopt the mandatory CMS appeals process. The overall benefit levels can be maintained and, in some cases, particularly for low-income people, they may actually receive an enhancement in benefits because there are certain cost-share requirements in EGWP that are actually lower than what are in place in the retiree plan right now. With the supplemental wrap plan, staff is doing a side-by-side comparison to understand where there may be small pockets where it does not match exactly what is in place today. That is anticipated to be very small. Most of the work with EGWP happens behind the scenes, and it is an administratively complex undertaking. The vast majority of members will not experience a change.

MS. RICCI said that CMS requires a narrower network of pharmacies than what the retiree health plan has right now. Staff is still working on completing the comparison between the two. She thought Aetna had approached all 25-27 pharmacies at this point, and at least ten of them are willing to participate in CMS’s narrower network.

COMMISSIONER FISHER assured MR. BRICE that the State was using Aetna, but Alaska’s taking advantage of the EGWP was not dependent upon Aetna.

MS. RICCI stated that CMS has required communications to the membership that the State must send out as part of participating in this federal program.

The explanation of benefits (EOBs) format will be different than what members see right now.

MR. BRICE asked if the Division of Retirement & Benefits intended to notify retirees about what to expect.

MS. RICCI said there would be a very intense communications process with retirees, and staff is working through that right now. Staff must understand where the differences are between EGWP and RDS so they can identify what the Division needs to communicate.

MR. MITCHELL asked if any of the changes being contemplated to comply with federal requirements would be considered an enhancement in benefits to retirees.

MS. RICCI replied that some of the changes would, and that is part of the analysis. Particularly for people who are low income, some of the cost-sharing requirements for EGWP are more advantageous than what they experience now. Staff needs to look at the wrap and the formulary to understand where those changes may be.

MR. BRICE sought confirmation that benefits to retirees would not be diminished.

MS. RICCI stated that at this point the Division anticipated being able to offer the same level of value of benefits under EGWP as prior. They are doing the analysis to make sure they are considering everything.

CHAIR ERCHINGER asked if the EGWP program was subject to federal budget appropriation such that the future funding could be subject to change.

MS. BISSETT of Conduent said she had not heard anything specific about whether EGWP could end at a certain date.

MS. RICCI said she called the consultant Seigel and asked them if there was a sunset date, and they had not heard anything about it at all. Any large federal programs are subject to federal approval or review. She added that most Medicare Advantage programs at this point use EGWP if they offer prescription drug coverage. A change to EGWP would not be minor, in terms of the plans that would be impacted. The Retiree Drug Subsidy (RDS) would be subject to the same exposure as EGWP to changes at the federal level. Many plans have moved from RDS to EGWP in the last six years. In 2011, 66% of large plan sponsors were participating in RDS, and at this point it is less than 5%.

MR. BRICE said it looked like the Alaska retiree health plan would be almost doubling its federal subsidies with EGWP. His sense from the news was that the trend in Congress and the Administration is to reduce healthcare costs, for example Medicaid expansion.

MS. RICCI noted that the focus right now is specifically on programs related to the individual healthcare market and Medicaid expansion. She has not heard any talk of significant changes to Medicare or programs related to that portion of the federal government spend. There is always uncertainty with federal funding, particularly right now in relation to healthcare, but the Alaska health trusts would have a net gain if they received the additional subsidies through EGWP for even one year.

MS. RICCI stated that CMS (Centers for Medicare and Medicaid) has certain requirements for clinical programs that staff is still evaluating to understand how that differs from what the retiree healthcare plan has in place today. She said that Medicare has higher premium standards for retirees with higher incomes, so staff is evaluating what impact that would have with EGWP and what Alaska's plan would have to consider. Another point is that with RDS the State remains the plan fiduciary, while with EGWP the PBM (pharmacy benefit manager) is actually the fiduciary of the Medicare Part D EGWP product.

MS. RICCI drew attention to slide 8, a financial analysis showing the low-to-high range of the EGWP subsidies, costs, and estimated savings for 2018. The estimated savings under EGWP range from $14 million to $25.7 million. She indicated she could provide a more detailed overview at the next meeting, if the committee was interested.

CHAIR ERCHINGER thanked Ms. Ricci for a good presentation.

## X. REVIEW 2017-2018 ACTUARIAL COMMITTEE SCHEDULE

A copy of the committee's 2017-2018 meeting calendar and list of proposed agenda topics for each meeting was included in the packet.

CHAIR ERCHINGER noted that the committee charter is on the next meeting agenda in October. She proposed getting a draft out to committee members well in advance, and that staff check whether a copy was forwarded to Stuart Goering for his legal review and any recommended changes. She surmised that a few other items might have jumped to the top of the timeline as a result of this meeting and would be added to the October agenda.

## XI. OTHER MATTERS TO PROPERLY COME BEFORE THE COMMITTEE

COMMISSIONER FISHER informed the committee that during the legislative session the Department of Administration received an inquiry from a legislative staffer that argued that the unfunded liabilities are not being amortized properly. The argument was that the intent of the legislation was not to have a single 25-year period, but as each new additional unfunded liability arose, it would have its own 25-year period that would be amortized. After some conversation and research, DOA does not have a position. The idea did not get a tremendous amount of traction, but he wanted to alert the committee that this issue was out there. It may be a topic in the next legislative session. The State assistance payment is starting to rise again, and there could be concern about the impact that has on the budget. In fairness, the proper way to interpret the legislation has been discussed between the legislature and DOA almost from the beginning.

MR. KERSHNER reported that Conduent was asked to do a projection of what the impact of the alternative interpretation would be. The way that Conduent reads HB385, it seems clear that it is a 25-year closed period. However, by the end of this week they hope to issue a letter with some projections to show how the two interpretations are different.

## XII. PUBLIC/MEMBER COMMENTS

There were no comments.

## XIII. ADJOURNMENT

The meeting adjourned at 3:38 p.m., on a motion by Ms. Harbo and seconded by Mr. Brice.

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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