State of Alaska
ALASKA RETIREMENT MANAGEMENT BOARD
ACTUARIAL COMMITTEE MEETING

Alaska State Museum, Lecture Hall
395 Whittier Street
Juneau, Alaska

March 28, 2018

ATTENDANCE

Committee Present: Kristin Erchinger, *chair* (by telephone)
Commissioner Sheldon Fisher (by telephone)
Gayle Harbo, *acting chair*
Rob Johnson
Commissioner Leslie Ridle
Norm West
Bob Williams (arrived 10:49 a.m.)

Committee Absent: Tom Brice

Department of Revenue Staff Present:
Pamela Leary (director, Treasury Division)
Bob Mitchell (chief investment officer)
Zach Hanna (deputy chief investment officer)
Sean Howard (state investment officer)
Michelle Prebula (state investment officer)
Stephanie Alexander (board liaison)

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

Others Present:
Scott Young (Conduent Human Resource Services, actuary)
David Kershner (Conduent Human Resource Services, actuary)
Leslie Thompson (GRS Retirement Consulting, review actuary)
Paul Wood (GRS Retirement Consulting, review actuary)
Sam Trivette

I. CALL TO ORDER

ACTING CHAIR GAYLE HARBO called the meeting to order at 10:13 a.m. (Chair Kris Erchinger was participating by telephone and had asked Trustee Harbo to perform the function of the Chair at the meeting location.)

II. ROLL CALL

Six committee members were present at roll call to form a quorum. Mr. Bob Williams joined the meeting at 10:49 a.m. to bring the attendance to seven members.

III. PUBLIC MEETING NOTICE

Board liaison STEPHANIE ALEXANDER confirmed that public meeting notice had been met.

IV. A. APPROVAL OF AGENDA

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

B. APPROVAL OF MINUTES – February 12, 2018

CHAIR ERCHINGER moved to approve the minutes of the February 12, 2018 meeting. MR. JOHNSON seconded. The minutes were approved as presented.

V. PUBLIC/MEMBER PARTICIPATION, COMMUNICATIONS AND APPEARANCES

There was no one present at the meeting or listening by telephone who wished to speak to the committee. There were no written communications for the committee.

VI. A. ACTUARIAL REPORTS

2017 Actuarial Valuations – PERS and TRS Defined Benefit and Defined Contribution Retirement Plans

DAVID KERSHNER and SCOTT YOUNG of Conduent HR Services presented an update to the preliminary 2017 actuarial valuation results they had discussed at the February 12 teleconference meeting. MR. KERSHNER said there were two major changes since the preliminary results. The weighting for the medical claims cost derivation was changed to a 50/50 weighting because the FY15 claims experience used in the previous weighting were questionable. The per capita claims costs are now set based on FY16 and FY17 claims experience. The revised valuation results also reflected some items that GRS, the review actuary, noted from issues they found in the test lives.

MR. KERSHNER also noted that these more detailed 2017 valuation results were final results, unless the committee requested further changes. *[A copy of Conduent's slide presentation of the June 30, 2017 valuation results for PERS/TRS is on file at the ARMB office]*

The presentation covered the purpose and background of the valuation, the main issues that were uncovered in the 2017 valuations, a brief review of the various inputs in a valuation, the various valuation results (the liabilities, funded status, contribution rates, gains/losses, etc.), and funding method considerations in connection with the experience study of which Conduent is scheduled to present the demographic assumptions at the May meeting. The demographic assumptions combined with the economic assumptions that were discussed in December will result in whatever new assumptions the Board adopts being used starting with the fiscal year 2018 valuations. Conduent has some new funding method considerations to implement in connection with the new assumptions as well. *[The Committee had heard much of the early part of the presentation at prior meetings. The minutes include any new information that Conduent discussed.]*

MR. KERSHNER noted that Conduent conducts valuations on the Judicial Retirement System and the National Guard Naval Militia Retirement System every two years and does roll-forward valuations for the interim years. They are doing roll-forward valuations this year, which reflect actual assets but rolled-forward membership data. Those are not complete yet because they have been focused on the PERS and TRS valuations and the experience study.

MR. KERSHNER stated that three main events happened in fiscal year 2017 that impacted the valuation results for both the Public Employees' Retirement System (PERS) and the Teachers' Retirement System (TRS). These applied to both the defined benefit plans and the defined contribution plans, although most of the effect was on the defined benefit plans because they are so large. There were net gains on the liabilities for PERS and TRS. There was a loss on the assets because, although the market return in FY17 was about 13%, not all of that gain is taken into the valuation of assets immediately because of the five-year smoothing method. Further, portions of the asset gains and losses from the previous two years have been brought in over five years. The actuarial value of assets, used to determine contribution rates, resulted in a return of about 5.5%, which is less than the 8.0% return assumption – which is why there were asset losses on the actuarial value of assets.

MR. KERSHNER said the third event in fiscal year 2017 that impacted the valuation results was on the healthcare side. Three items impacted the healthcare liabilities the most. One is that Conduent revised the medical and prescription drug trend rates upward, which increased the prescription drug liabilities. Conduent is also now reflecting the Cadillac Tax, which previously had been considered immaterial, and that resulted in a loss on the healthcare side. Partially offsetting those two losses are the gains from the new per capita medical claims costs. The net effect of the three items on the healthcare side was a loss.

MR. KERSHNER next talked about the inputs in the valuation process, starting with the plan membership data for the PERS and TRS plans. The other inputs he covered were asset data, benefit provisions, actuarial assumptions, and funding methodology *[covered in detail at prior meetings]*.

He pointed out that the State assistance contribution for PERS and TRS went entirely to the pension side for FY2017 and nothing to the healthcare side. The committee and the Board made that decision for FY2017. Conduent understood that the same decision applied to fiscal year 2018. In the projections for setting the FY2020 contribution rates, Conduent has assumed that the Board will make the same decision to allocate the entire State assistance to pension for FY2019. But that decision has not been made yet.

MR. JOHNSON asked if there was a statistic of how much contributions in a particular year relate to the unfunded liability payoff versus the ongoing normal costs. He wanted to know much of the employer contribution up to 22% for PERS (where the State assistance contribution kicks in) was made up of the unfunded liability.

MR. KERSHNER said that Conduent has the unfunded liability and normal cost broken out for FY2019 and FY2020 on slide 23. [He provided a more detailed answer on page 9 of these minutes, paragraph 3.]

There were no changes in benefit provisions for PERS and TRS since the FY2016 valuations. Conduent reflected the Cadillac Tax impact for the first time: that was not a change in the plans but a change in the actuary's methodology.

Regarding the actuarial assumption inputs (demographic and economic), MR. KERSHNER stated that Conduent did not change any of the assumptions since they were set in 2014, except for the medical claims costs that are updated annually, and the medical/prescription drug trend rates that were revised this year. The assumptions that Conduent discussed in December and the assumptions they are going to discuss at the May meeting are not going to be reflected in the FY2017 valuations.

There were no changes in the funding methodology, which is comprised of three categories:

- The actuarial cost method allocates the value of projected benefits into past service, which is the accrued liability, and future service, which is the normal cost for benefits accruing during the year. The entry-age normal cost method is used and develops normal costs that stay level as a percent of payroll. Conduent would be talking later about potentially changing the way the healthcare normal cost is determined, which is different than the pension normal cost.
- The asset valuation method smooths or averages the market returns over time to lower volatility in the contribution rates. The assets were reset to market value as of June 30, 2014. The five-year smoothing method was resumed beginning in FY15. Gains or losses in the market return are recognized 20% per year.
- Based on statute, the amortization method to determine the payment schedule for the unfunded accrued liability is a 25-year closed period and was established in 2015. The unfunded liability will be fully funded by 2039.

Conduent has not changed any of the funding methods. The potential change to the healthcare normal cost has not been implemented, but Conduent would like to implement it for the next valuation.

CHAIR ERCHINGER asked Mr. Kershner to expound on a potential recommendation to change the amortization method by statute in the future.

MR. KERSHNER explained that Conduent's suggestion is to consider setting up a layered approach, instead of using a closed 25-year amortization period. In that alternate approach, the existing unfunded liability would continue to be amortized over the 25-year period, and any new increases or decreases in the unfunded liability – which might be caused by changes in assumption, changes in claims experience, and just regular changes in the liabilities – would be amortized over a new time period. Under the current approach, as the 25-year amortization period gets shorter and shorter, any swings in assets or liabilities will be amortized over a very short period of time because the time is whatever is left of that 25-year period. That could potentially cause significant volatility in the contributions, up or down, related to the unfunded liability. Any change in the amortization period would have to be a change to the Alaska statute governing the ARMB.

COMMISSIONER FISHER stated that he was not certain it would require a change in statute. This topic came up in the last six months because certain members in the Legislature were challenging the way the Alaska Retirement Management Board (ARMB) was doing the amortization of the unfunded liability. They believe that the proposed change that Mr. Kershner just described was actually what the Legislature intended. He suggested continuing this discussion later in the meeting.

CHAIR ERCHINGER questioned whether the committee needed to focus on it at this meeting, because she viewed it as a new and material discussion topic. She appealed for the committee to focus on completing its review of the FY2017 valuations.

Chief Investment Officer BOB MITCHELL asked what the best practices were for the number of years over which new unfunded liabilities would be smoothed, for those retirement plans that do use a layered amortization approach.

MR. KERSHNER replied that a plan can apply shorter periods for something like experience gains and losses or changes in assumptions, or longer periods for things like benefit plan changes. They would probably not go beyond 20 years for any particular change. He pointed out that the defined contribution plans currently have a layered approach and amortize different sources of losses over different periods. The ARMB could adopt what the DCR plans are using.

MR. JOHNSON remarked that it sounded like the Board needed to get some guidance from the Attorney General's Office before knowing whether the committee even wanted to embark on this conversation.

COMMISSIONER FISHER said the Department of Administration had had some initial conversations with the Attorney General's Office, and he got a sense that the statute is broad enough to reflect that. That is why he thought there was an opportunity if the Board wanted to pursue this.

CHAIR ERCHINGER said Conduent was indicating there are different approaches to take in applying the amortization period, and it warranted being a separate discussion topic. She thought it best to get a ruling from the Attorney General's Office included in that conversation at the same time, so the committee had complete information before making a recommendation to the Board.

ACTING CHAIR HARBO said the committee could put this topic on the June meeting agenda, allowing time to possibly get an opinion from the AG's Office and also for GRS, the review actuary, to prepare their response.

MR. WEST asked that Conduent provide the committee with information on what other similar plans do and also present their own recommendation. MR. KERSHNER indicated they could do that.

MR. KERSHNER proceeded to present the FY2017 valuation results for PERS and TRS *(starting at slide 16)*. He explained the calculation of smoothed assets, noting that the actuarial value of assets is about 3% higher than the market value. He reviewed the funded status of the plans, saying there was a slight decrease in the funded status from last year for both PERS and TRS. Conduent expects that the funded status will increase gradually going forward until reaching 100% in 2039 – absent any future gains or losses on both assets and liabilities.

MR. WEST commented that implementation of the Cadillac Tax portion of the Affordable Care Act (Obama Care) has been pushed out again, this time to 2022. He asked how much of that Conduent was taking into account.

MR. YOUNG said the main reason why Conduent now includes a liability for the Cadillac Tax for the Alaska plans is that as part of the Tax Cut & Jobs Act of 2017 there was a change in the law as to how that tax limit is increased in the future. Previously, the Cadillac Tax was increased by CPI (Consumer Price Index). Now it is increased by what is called Chained CPI, which is a lower index. That means more of the cost for providing healthcare will be above the threshold. With that change, the liability for the Cadillac Tax has reached the point where it is not as immaterial in the valuations as it used to be. Currently, it is half a percent or less, so still very small.

MR. WEST offered that his reading about the Cadillac Tax seems to indicate that the tax will be litigated when it is finally assessed.

MR. YOUNG agreed that there was a chance that the Cadillac Tax might not go into effect.

Health Claims Actuarial Gain

MR. KERSHNER moved on to the summary chart of the sources of gains and losses on the liabilities for PERS and TRS in fiscal year 2017 *(slide 20)*.

At the request of COMMISSIONER FISHER, MR. YOUNG explained that more precise enrollment data from Aetna, which allowed Conduent to better allocate the pre-Medicare and Medicare claims, was partly responsible for the trend assumption going up while the medical claims experience had decreased. The other factor is that the trend assumption is a prospective looking assumption, and what really changed was the prescription drug trend rate. Based on Conduent's survey data and the general market, prescription drug costs are expected to increase at close to 10% per year. The current assumption is around 5.5%. That is why the trend assumption was increasing liabilities.

COMMISSIONER FISHER asked if Conduent increased the prescription drug cost assumption all the way to 10%. MR. YOUNG said they used 9%.

COMMISSIONER FISHER said the State has been engaged in a number of activities to try to manage healthcare costs more efficiently. He understood Mr. Young to say that the claims experience has not reflected a positive effect from the State's efforts and that the only positive effect has been because Conduent received better data.

MR. YOUNG said that was essentially correct. The averages were a little bit lower than the way the claims were calculated before because the claims were in separate Medicare and pre-Medicare buckets. Conduent is basing how much they expect claims costs per person to increase in the future on trend survey data.

COMMISSIONER FISHER said it sounded like Conduent relied on a survey of experts to measure what will be happening on medical/Rx claims and did not try to assess whether the State of Alaska is actually able to maintain a trend below expectations.

MR. YOUNG stated that a lot of surveys are showing 10%-plus increases. Conduent started out at 9% for the Alaska plans, without having a real good way to quantify how much the State's activities are going to lower the per-person cost.

CHAIR ERCHINGER said the Commissioner raised a good question of whether there is any way to gauge the impact of the State's actions. It seemed to her that because the prior data was not differentiating between the pre-Medicare and Medicare members, it is an apples-and-oranges comparison, and the actuary may not be able to discern the changes from the past up to today. But going forward, it might be possible to better gauge the savings that might be accruing due to health plan changes as opposed to the data changes.

MR. YOUNG agreed that as Conduent gets more data in the same format they are getting now they will be able to look on a per-person basis at how much change occurs from year to year and assess how well that is affecting the costs.

LESLIE THOMPSON of GRS, the review actuary, stated that the medical claims experience that the Commissioner was questioning has embedded in it a change in method, which is not related to experience. She added that it is a legitimate question to ask Conduent where they are *estimating* who has what coverage versus where they are getting actual data. Conduent still has to estimate on the dependent side who is in Medicare and who is not. They do not have actual data on the eligibility side but they do on the claims. Conduent also has to do an estimation technique on who is married with dual coverage. To the extent that there is not actual data, there is a risk for changing numbers when estimation techniques are used.

ACTING CHAIR HARBO commented that it is very discouraging to not know accurately who is enrolled in Medicare and who is not, because it seems like such a simple question when people's birth dates are known.

COMMISSIONER RIDLE asked if the problem for getting actual census data on who is pre-Medicare and who has Medicare coverage resided with the State or with the third-party administrator (TPA).

MR. YOUNG replied that Conduent has a good process now if the same data reports are available. However, if Aetna could provide a report that cleanly gives the right number of people who are pre-Medicare and Medicare, then Conduent would use the actual counts and not have to make any adjustments (allocations based on the TPA's snapshot files). There are thousands of people who are in the wrong "bucket."

COMMISSIONER RIDLE said an RFP would be issued soon for a third-party administrator. She wondered if the census data issue was something the department should pay attention to on the front end to make sure the actuary is always getting the right data to perform their work.

MS. THOMPSON stated that GRS works with Aetna on other state plans and Aetna does provide the data that is needed. She guessed it was something in the contracting with the TPA and advised that Alaska address the data issue upfront.

MR. WILLIAMS remarked that the discussion reminded him of the proxy data issue in the past related to estimates of whether a member was married or not. The committee has a duty to reduce uncertainty in the data, although it cannot be eliminated altogether, such as not knowing exactly when people are going to retire. The committee has seen changes when real data was obtained and used in place of proxy data. He would appreciate that Conduent, when they are making estimates for things they are uncertain about, to let the committee know. The more the committee and the State can figure that sort of thing out, the more certain they can become with the outcomes.

MR. YOUNG explained that in the past Conduent got a standard report of claims experience from Aetna. Conduent then had to make adjustments to estimate who was pre-Medicare or Medicare eligible, and convert paid claims to incurred claims. It was a lot of inefficient work but the report from Aetna did not cost the State any extra. He appealed to Michelle Michaud and Kevin Worley in the Department of Retirement & Benefits this year, and they were able to run a report from the data warehouse that splits the claims purely between pre-Medicare and Medicare. Conduent did not make any adjustments to that data. It is now very transparent where the claims experience information comes from and how Conduent uses it. Regarding enrollment, Aetna could make an enhancement to give Conduent clean, pre-Medicare and Medicare enrollment numbers by month. Conduent could use that without making any estimates or adjustments. Right now, they do have to make adjustments because those reports do not have a clean split. In addition, the total members number includes people who are counted twice: a retiree and a spouse who are both retirees from the state system both cover each other as a dependent, so they are showing up as four people instead of two people. Conduent has to adjust the counts for that fact because about 13% of the retirement system population is in that situation. Instead of a little over 70,000 unique individuals that show up on the reports, there really are about 62,000 unique individuals who are getting benefits from the plans. Conduent cannot use the 70,000 count that Aetna gives them because it includes a lot of duplicates. That is the proxy data that was taken care of a couple of years ago.

MR. KERSHNER asked if there were any further questions on slide 20, the medical claims experience results for PERS and TRS.

MR. YOUNG added that when Conduent initially did the first set of preliminary valuation results they had used three years of claims experience – fiscal years 2015, 2016 and 2017. They had noted that the FY2015 claims total was very low, and he had talked with Mr. Worley about it before releasing the initial valuation results. Because FY2015 claims experience was so much lower than in previous years, he did not think it was something they should have used in the valuations. He had already talked with the committee, and the committee was comfortable with using a three-part percentage weighting of 40-40-20 for those three years. On further investigation, Ms. Michaud found out that, when FY2015 was extracted from the data warehouse, four months of claims were missing because they had been archived out of the system. The data was clearly not correct. Conduent changed the method and used a 50-50 weighting on the two most recent years of claims experience. That reduced the big gains that Conduent had originally seen. While still significant, the liability gains are more accurate.

MR. KERSHNER next presented the calculations for the final FY19 contribution rates and preliminary FY20 contribution rates for PERS and TRS *(slides 23 & 24)*. The FY20 actual contribution rates will be set in the Fall after Conduent has received the actual asset performance as of June 30, 2018.

Responding to an earlier question, MR. KERSHNER pointed out the total PERS defined benefit and defined contribution actuarial rate of 31.63% for FY20 (estimated). Of that, 17.43% is the past service rate, meaning 17.43% of total payroll is being allocated to pay off the unfunded accrued liability. That is before the split between the employers and the State because of the cap. He walked through the mechanics of how that gets allocated. In the end, the State assistance contribution toward the past service is 6.61%. The PERS employers' contribution rate is capped at 22.0%, and roughly 11% goes toward paying off the unfunded accrued liability.

When MR. JOHNSON raised the question about the amount of the State assistance going to past service, COMMISSIONER FISHER chimed in that he made a good point – the State assistance is oftentimes characterized in discussions as a contribution on behalf of others, and probably half of it is a contribution on behalf of its own employees.

COMMISSIONER FISHER asked if the total payroll included benefits or was just the cash portion of the compensation.

MR. KERSHNER replied that total payroll was base salary and whatever other components of salary are considered pensionable earnings and did not include benefits.

MR. KERSHNER next showed two long-term projection charts of all the contributions to the PERS and TRS defined benefit plans for the employers, State assistance, and the employees. He pointed out that the last year of the State assistance contribution is 2039 because that ends the 25-year closed period for amortizing the unfunded liability.

Funding Method Considerations

MR. KERSHNER said there were potentially three funding method considerations:

1. Level dollar versus level percentage of pay for healthcare normal cost. The current method for healthcare normal cost is level dollar. Level percentage of pay basically calculates all the present value of future benefits, then goes back to the point that the person entered the plan and calculates what their normal cost would be as a percentage of their pay at entry age and assumes that to be constant going forward. Level dollar is whatever the normal cost is in the future and allocated it on a level dollar basis.

   The current method for pension allocation is level percentage of pay. He said he did not know why the method for healthcare normal cost was set at level dollar. He guessed it was because the accounting under GASB 43, which is the accounting for the retiree medical benefits, was done on a level dollar basis. Funding may have been set to mimic it, but it was done a long time ago. GASB 43 has now been replaced by GASB 74, which are accounting statements that relate to retiree medical benefits. GASB 74 specifically requires level percentage of pay. The GASB 74 reports that Conduent provides to staff are done on a level-percentage-of-pay basis. So, now there are two methods, one for funding (level dollar) and one for accounting GASB 74 (level percentage of pay).

   Conduent's suggestion is to sync those together. Because they are required to do it on level percentage of pay for accounting, they recommend changing it for funding healthcare normal cost, which would also be consistent with the way the pension is being funded.

   MR. JOHNSON wondered if back in the past the Legislature addressed this and gave direction or intent to go with the level dollar method for healthcare normal cost. The committee should check if the Legislature spoke in some fashion on this.

   CHAIR ERCHINGER asked if discussion of this funding method was with respect to the FY2018 valuations.

   MR. KERSHNER responded that their thought on this was in connection with all the assumption changes and potentially other method changes (below) going into effect in 2018. There is nothing that says it has to be for the FY2018 valuations.

   CHAIR ERCHINGER said she agreed with Mr. Johnson about getting guidance as to what the Legislature's intent was at the time of the legislation. She was also interested in seeing the impact of the change to the level percentage of pay method for healthcare normal cost on future projections.

   MR. KERSHNER stated that Conduent calculated it as if the change were in effect at 6/30/17. The change of going from level dollar to level percentage of pay for the healthcare piece allocates more to the future and less to the past. It means that if the change were made effective 6/30/17, the actuarial liability for healthcare would be lower than what it is currently, and the normal cost would be higher. The effect on the contribution rates would be the effect on the normal cost rate and the amortization of the unfunded liability – it basically would increase the contribution rate by approximately 100 basis points.

CHAIR ERCHINGER said she was interested in seeing that analysis side by side.

MR. KERSHNER said it was already done, so he could provide it to the committee after the meeting.

2. <u>The period used to amortize the unfunded actuarial accrued liability</u>. MR. KERSHNER stated that they had discussed this earlier in the meeting. He went into more detail about it on slide 30, an illustrative chart of what the unamortized portion would look like starting at 6/30/30 under the current method and if a 20-year layered approach were implemented for all sources of changes in the unfunded liability. If in 2030 there were to be a significant drop in the market or a really bad year or two of claims that resulted in larger unfunded liabilities, in 2030 it would be amortized over nine years under the current method or 20 years under the illustrated method. That type of volatility would be eliminated by going to a layered approach.

   CHAIR ERCHINGER asked if there was best practice in the layered approach for liabilities, especially for a closed retirement system. She asked if Conduent has seen the layering done in different ways in different places. She thought it made sense to have some level of layering, but she did not like to see the increasing number of years to pay off the liabilities. In the example provided, at the year 2039 there was still 20 years to go to amortize any of those gains and losses.

   MR. KERSHNER indicated that, based on the earlier discussion, Conduent intended to look into what are best practices and present their findings at an upcoming meeting. It might be difficult to get information specific to closed pension plans. He agreed with the Chair's interpretation, saying that the gain or loss that occurs in FY2030 in the example on slide 30, instead of having it fully funded by 2039, it would be fully funded by 2050. The purpose of putting in a layered approach (over a period of the Board's choosing) is to remove the volatility.

   MR. WILLIAMS pointed out that under the present method illustrated on slides 25 and 26 the contribution rates are increasing and the State assistance contributions are going to be increasing. If there were a negative event late in the amortization period, it would add to what is already a hefty State assistance amount.

   CHAIR ERCHINGER mentioned that if there were a large gain in the final year of the amortization period, there could be federal tax ramifications if the plans suddenly became overfunded. She added that if one were to look at the projections on slides 25 and 26 in Conduent's valuation report today, a few years ago the projection was showing that the State assistance contribution would be approaching a billion dollars a year. That is why the ARMB went to the Governor originally and asked for $3 billion and asked the Administration through the Governor what assistance amount was affordable for the State, to figure out how to come up with a level dollar payment that was affordable in order to avoid the State assistance payments continuing to increase when everyone knew the State revenues were declining. The ARMB got the $3 billion allocation to PERS and TRS, which was awesome. But then it went back to the level percentage of pay method, which assumes that people's pay in the aggregate over time will increase and, therefore, the contributions would increase. That is counterintuitive to the situation that the State is in. So, while Mr. Williams is right about the contributions and State assistance increasing under the current projections, it is important to look back at what is being paid today (slightly over $200 million) versus three, four or five times that amount.

COMMISSIONER FISHER stated that both comments are right. Mr. Williams' point about what a negative event could do late in the amortization period should be factored into the conversation.

3. <u>Adding an explicit assumption to the normal cost contribution rate for administrative expenses (suggested starting with the FY18 valuation)</u>. Currently, the investment return assumption of 8%, which may be lowered or may be kept as is, is assumed to be net of investment expenses and administrative expenses (except for National Guard, which has an explicit administrative expense assumption). That means that the 8.0% assumed return is actually higher than 8.0%.

   MR. KERSHNER said Conduent suggested changing the investment return, whether it is 8.0% or some other percentage, to be net of investment expenses only, and then adding something to the contribution rate to cover expected administrative expenses in the upcoming year. Currently, the National Guard uses a two-year average of administrative expenses. If the ARMB were to put an explicit assumption in place for administrative expenses effective 6/30/17, the total employer/State contribution rate would increase by roughly 100 basis points for the PERS and TRS defined benefit plans and much less for the DCR plans. Conduent suggested that the change be implemented beginning with all the other assumption changes that are going to be implemented with the FY2018 valuations.

   COMMISSIONER FISHER asked why the assumption for administrative expenses was not part of the overall discussion of the experience analysis.

   MR. KERSHNER said Conduent had intended to discuss this when they got to the demographic assumptions part of the experience study. Then the presentation on the demographic assumptions was delayed until the May 3rd meeting. They were bringing up the administrative expenses to the committee today, but the Board would consider all the assumptions together at a future meeting.

B. UPDATE OF THE 2017 ACTUARIAL REVIEW (Draft)

MS. THOMPSON and PAUL WOOD, with GRS Retirement Consulting, the review actuary, accompanied their report with a short slide presentation, which is on file at the ARMB office. MR. WOOD explained that GRS looks at test life detail for a sample of the plan membership. They look at data inputs, the assets, the assumptions and methods to make sure those are being correctly employed, and if the plan provisions are being applied correctly and projecting the proper benefits going forward.

MR. WOOD stated that they have been doing this for a few years, and the differences they are finding now are rather small. A couple of items that Conduent agreed to from GRS's test life review last year wound up not being changed when GRS received the test lives this year. GRS talked to Conduent about that, and Conduent made one change and updated their valuation report this year related to the survivor PRPA (post-retirement pension adjustment) for PERS DCR and TRS DCR actives. Correction of the TRS defined benefit active issue, where an extra withdrawal percentage is applied to a small portion of death benefits, will go into next year's valuation report. This will not materially change any of the results.

MR. WOOD listed the new issues their review brought to light this year:

- PERS DCR PF Active – the marriage assumption applied incorrectly for a small portion of the deferred disability benefit. Changed in this valuation.
- PERS DCR PF Inactive – The disability benefit was being valued improperly. A portion of the benefit was accidently set to zero, and the liabilities decreased more than was expected. When informed, Conduent was able to fix that issue.
- PERS DCR Other - Deferred Disability Healthcare - Member had less than 20 years of projected service which should have equated to the member's share of the healthcare premium being 25%. Instead, too much service was projected out, so the retiree's share of the premium was being understated. That issue was fixed.

MR. WOOD stated that while these types of nit-picky items pop up every year, it is great due diligence to go through and check every single decrement and every benefit that is being valued by the actuary to make sure the assumptions and methods and benefit provisions are being valued properly.

MS. THOMPSON reported that GRS was once again floored by another billion-plus dollar gain on the PERS and TRS defined benefit plans for healthcare. GRS pushed on that issue because there were X number of medical claims in FY2015, and those claims should not go missing when the data was extracted – but they did. Conduent ended up having to fix that and re-do the valuation, because it was discovered that Aetna's system had archived four months of claims for 2015. Rather than fixing FY2015, Conduent recommended dropping the 2015 claims experience from the method for averaging the per-person claims cost. To GRS it feels now like the bucket of claims is good but the bucket of people feels a little shaky: the data does not have every single thing on every single person, and the actuary still has to use some estimation methods.

MS. THOMPSON noted that the issue of double counting retirees with spouses who are also retirees has been resolved, but there is still an estimation technique on who is married to whom and who is being counted.

CHAIR ERCHINGER sought to clarify the billion-plus dollar gain from healthcare on the PERS and TRS defined benefit plans, saying that it was not that Aetna cannot account for those healthcare claims. It is that when projecting what healthcare costs will be in the future, the plans in the past were not properly accounting for healthcare costs because the actuary was using information that was based on estimates and not substantiated. She asked that GRS put that into appropriate terms.

MS. THOMPSON stated that GRS was not saying there was missing money or missing claims. They were saying that the prior methods had a higher cost when looking at the future liabilities. When those methods changed, it came out a billion dollars to the good.

MS. THOMPSON briefly addressed the year-to-year volatility in data counts that has resulted in significant gains on the healthcare side. First it was from eliminating double counting of retirees with dual healthcare coverage, and then this year getting much more accurate counts of pre-Medicare and Medicare members. Her view was that Mr. Young and Conduent are providing more transparency on the data than ever. She believed that getting to the real data will mean managing the volatility and it will stop. She said Mr. Young gave GRS screen shots of the data that they had not seen before, which gave them a lot more confidence in the claims. GRS is not as confident in the head counts because there are still approximation methods in that, but it is better. Mr. Young has disclosed where he has made the approximations, information which GRS and the ARMB did not have before.

CHAIR ERCHINGER added that Mr. Young and Conduent should get significant credit for where things are with respect to uncovering these issues. The situation was not really anybody's fault. She thought Aetna was not pushed to disclose more transparent data, but now, with pressure from the Administration and the Board, they are required to. Conduent is able to ask the hard questions and get to the crux of the issue. The ARMB does not like to see the billion-dollar gains for two years in a row, but Conduent deserves a lot of credit for getting to this point, and the Administration as well for recognizing how important it was to get better numbers. She thanked everybody for getting things this far. With better transparency, everyone will feel better about the numbers going forward.

MS. THOMPSON stated that GRS has questioned the healthcare data every year for about 12 years. With better transparency available through Conduent, everyone has learned about the issue of Aetna basing a dependent's status on the retiree's Medicare or pre-Medicare status. GRS's recommendation is to get Aetna and Conduent in the same place and get the data needs in writing, and make sure to get data from Aetna on every person and what their coverage is. In closing, she said GRS received the revised valuation reports yesterday and would continue their review.

Action Item: Changes to 2017 Valuation Reports for PERS and TRS DB Plans

ACTING CHAIR HARBO directed attention to the memorandum in the meeting packet that gave the background and the actuary's recommendation.

Conduent had recommended the following changes be implemented for the June 30, 2017 PERS and TRS actuarial valuation reports:

- Trend rate increases as shown on slide 43 of the Conduent presentation from the December 6, 2017 Actuarial Committee meeting (see attached Item A).
- Claims cost development methodology as shown on slide 9 of the Conduent presentation from the February 12, 2018 Actuarial Committee meeting to use a 50/50 weighting of FY16 and FY17 experience (see attached Item B).
- Cadillac Tax impact as shown on slide 7 of the Conduent presentation from the February 12, 2018 Actuarial Committee meeting (see attached Item C).

MR. WORLEY stated that the recommended changes were already included in the FY2017 valuation reports, but this action was to confirm with the committee and the Board that this was the route to go.

Addressing the Cadillac Tax, COMMISSIONER FISHER stated that while it is a small amount, he guessed that over time that may change. He noted that Trustee West earlier had raised the notion that the tax might never materialize. He asked Conduent to address the question of the proper way to deal with a law that has some uncertainty, as the Cadillac Tax does. He asked if they believed that most plans are now starting to account for the future impact of the Cadillac Tax in their valuations.

MR. YOUNG stated that all plans that he works on have accounted for the tax. Whether they deem it immaterial or not is a different issue. Some plans have a cap where the retiree pays any costs above that level. Any Cadillac Tax that would be incurred would effectively be paid by the employees, not the organization, so they do not value it at all. As actuaries, if a law is in place, they have to account for it and determine if it is material or not. For the Alaska plans, prior to the change that was made recently that changed CPI to Chained CPI, the tax was such a small impact, even when projected out under the assumption that it would go into effect. When Conduent checked this year to see if the Cadillac Tax was material, they felt it exceeded the threshold of not being immaterial any more and thought it prudent to put it into liabilities. They realized there is uncertainty on whether the tax will actually come into play, but as of now they have measured and quantified the impact if it does go into effect.

MR. JOHNSON moved that the Actuarial Committee recommend that the Alaska Retirement Management Board direct staff and the consulting actuary to implement the changes noted above into the June 30, 2017 Public Employees' Retirement System and Teachers' Retirement System defined benefit plans actuarial valuation reports. COMMISSIONER RIDLE seconded.

The motion passed without objection, with seven committee members present.

C. REVIEW TIMELINES: VALUATION AND EXPERIENCE STUDY

Conduent had provided two updated spreadsheets at the meeting showing the timelines for the June 30, 2017 valuations and for the experience study.

MR. KERSHNER briefly pointed out a few highlights on the schedules.

When queried, MS. THOMPSON said GRS got the valuation reports yesterday, so she did not know if they could still meet the April 6 deadline to get their draft actuarial review report to Conduent. They would do their best to get that draft report out.

MR. KERSHNER stated that Conduent incorporated all GRS's comments from the original reports, so he did not expect there to be additional items.

MS. THOMPSON noted that the schedule had GRS submitting a draft experience analysis review report to Conduent by June 1. She did not know when GRS was receiving the experience study report from Conduent upon which to conduct a review.

MR. KERSHNER said the plan was that GRS was going to issue comments on the results of the experience study as opposed to a report. Conduent had planned to prepare a report based on all the assumptions that were discussed in December and upcoming in May, and then in September incorporating any GRS comments. If GRS would like a draft report, Conduent could certainly do that, and that would obviously push everything back.

MS. THOMPSON said she would defer to the committee, because she did not know if the statute required GRS to review a report or not. As she understood Mr. Kershner, she would be reviewing the data that Conduent sent over.

MR. KERSHNER added to that the recommended assumptions based on that data. The one thing still to come is Conduent's revised mortality assumption.

VII. FUTURE MEETINGS

A. Calendar Review

The schedule of 2018 meetings was included in the packet. The next meeting is Thursday, May 3 in Anchorage. The following meeting would be Wednesday, June 20 in Anchorage.

B. Agenda Items - None

C. Requests / Follow-Ups

Items brought up during the meeting were: (1) get a legal opinion from the Attorney General's Office on the issue of a layered approach to the amortization time period for the unfunded liability, and (2) research the Legislature's intent in going with the level dollar method for funding healthcare normal cost.

VIII. Adjournment

Mr. West moved to adjourn the meeting, and Commissioner Ridle seconded. The meeting adjourned at 12:15 p.m.

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

Confidential Office Services
Karen Pearce Brown