State of Alaska
ALASKA RETIREMENT MANAGEMENT BOARD
ACTUARIAL COMMITTEE MEETING

Location:
Robert B. Atwood Building
Conference Center, 1st Floor
550 West Seventh Avenue
Anchorage, Alaska

December 12, 2018

ATTENDANCE

Committee Present: Kristin Erchinger, *chair*
Commissioner John Quick
Tom Brice
Robert Johnson
Gayle Harbo
Norm West
Bob Williams

Committee Absent: None

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

Department of Administration Staff Present:
Ajay Desai (director, Division of Retirement & Benefits)

Others Present:
Stuart Goering (assistant attorney general, Department of Law)
David Kershner (Buck)
Scott Young (Buck)
Paul Wood (Gabriel Roeder Smith (GRS))

I. CALL TO ORDER
CHAIR KRISTIN ERCHINGER called the meeting to order at 10:04 a.m.

II. ROLL CALL
Seven committee members were present at roll call to form a quorum.

III. PUBLIC MEETING NOTICE
Board liaison STEPHANIE ALEXANDER confirmed public meeting notice had been met.

IV. A. Approval of Agenda

MS. HARBO moved to approve the agenda. MR. WEST seconded the motion. The motion passed without objection.

B. Approval of Minutes - September 19, 2018

MS. HARBO moved to approve the minutes of the September 19, 2018 meeting. MR. WEST seconded the motion. The motion passed without objection.

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. GRS REVIEW OF 2017 EXPERIENCE STUDY

CHAIR ERCHINGER requested PAUL WOOD, GRS, present the review of the 2017 experience study performed by Buck. MR. WOOD conveyed he undergoes this actuarial process with many clients and understands the gravity of the decisions to be made. He commended the Committee for the exhaustive review of the experience and for taking the time to fully comprehend the implications and the impacts of changing the actuarial assumptions. MR. WOOD explained the process of setting assumptions includes these primary questions:

- How do the assumptions affect the risk profile of the plan?
- How do the assumptions affect the ideas of benefit security and sustainability?
- Do the assumptions help promote the concept of intergenerational equity?

MR. WOOD conveyed there are no serious concerns with Buck's 2017 experience study assumptions or methods. He noted GRS is very cautious regarding the investment return discussion. Most of the actuarial comments address differences in professional judgment. GRS concurs with the overall recommendations of the demographic assumptions. He agrees the public sector mortality table, Pub 2010, should not be used at this stage in its draft. Considerations of Pub 2010 may occur at a later date. The current RP-2014 tables with the projection scales are sufficient at this time.

MR. WOOD discussed the question of why Buck is increasing the termination rates of teachers at older ages. The observable evidence showed teachers are working until older ages before termination. It was determined this is not a material issue and does not have a significant impact on the cost of the plan.

MR. WOOD noted the healthcare cost trend rates, morbidity, and participation assumptions in the experience study were found to be reasonable. GRS noted some items have been discussed with Buck and staff, but were not addressed in the experience study report. GRS concurs with the assumptions regarding the relative value between DCR and DB plans, the prescription drug rebate, and the employer group waiver plan (EGWP). However, there is a risk the EGWP subsidies could be repealed and thus, the costs would immediately increase. MR. WOOD recommended the disclosure of this risk is included in the valuation report.

MR. JOHNSON inquired as to why the EGWP risk was not considered in setting the FY20 contribution rates. MR. WOOD explained the budgeting reasons for the administrative lag between the time of the evaluation and the contribution rate decisions. The decisions are based on the best information available at the time. Evaluations are self-correcting and will adjust upward or downward based on the experience and the assumptions used.

MR. WEST asked how other public retirement plans are preparing for the potential degradation or conclusion of EGWP. MR. WOOD reported the State of California has built in higher trend rate assumptions since 2012 to gradually erode the subsidies by 2022. SCOTT YOUNG of Buck commented there is a risk of EGWP ceasing, but the common practice is to assume EGWP will continue. There is also a risk RDS could cease and no special adjustment is currently being made. Changes will be addressed in the future when they occur.

MR. WOOD noted GRS does not professionally concur with the assumption of a .2% decrease in the claims cost for the DCR plans. There is no basis given in the valuation for this assumption and it would be more conservative to value the plan as it is stated today. MR. YOUNG explained the .2% assumption is derived from the plan document stating the DCR plan can change provisions like deductibles, coinsurance, and copayments to help manage the cost in the plan. The assumption is maintained with the intent to smooth the volatility of the years when the changes are made.

MR. WOOD discussed the economic assumption findings and the risks associated with each. Buck recommends lowering the current inflation assumption rate from 3.12% to between 2.5% and 3%. GRS concurs lowering the inflation rate to around 2.5% is prudent. MR. WOOD stated GRS is comfortable recommending a real return assumption between 4.5% and 5%. The plan's current real return assumption is 4.88%. One of the issues is the amortization of a significant portion of the unfunded accrued liability as a level percent of pay. If payroll does not increase at its assumed rate each year, the cash that comes in the plan will be less than anticipated and future contributions will have to increase.

CHAIR ERCHINGER summarized GRS' concurrence with Buck regarding the inflation assumption rate at 2.5% and the real return assumption rate at 4.88%, which produces an assumption for investment returns at 7.38%. MR. WOOD agreed. CHAIR ERCHINGER noted GRS' concurrence with Buck's recommendation to change the payroll growth assumption from the inflation rate of 3.12% plus 50 basis points to the inflation rate of 2.5% plus 25 basis points, for a total payroll growth assumption rate of 2.75%. MR. WOOD agreed and noted the change will result in a decreased reliance on payroll growth.

CHAIR ERCHINGER expressed appreciation to Buck for offering a range of recommended acceptable assumptions rates, rather than a specific number for each. She believes this process was consistent with the Committee's thinking and provided the opportunity for robust discussions, which resulted in the arrival of a comfortable rate. CHAIR ERCHINGER thanked GRS for their observations during this process.

VII. 2017 EXPERIENCE STUDY

1. **Assumptions Discussion**

CHAIR ERCHINGER requested DAVID KERSHNER of Buck to lead the 2017 experience study assumptions discussion. MR. KERSHNER stated some of the materials presented are follow-up responses to questions during the September meeting. The current and proposed assumptions displayed were discussed at the previous meeting. Six attachments were included in the packet:

- Summary of current and proposed assumptions/methods from 2017 experience study
- Considerations in setting the healthcare trend rates
- Current and proposed healthcare benefit payments and PV benefit payments
- UAAL amortization method
- Projected contribution rates and DB plan contributions - PERS
- FY20 normal cost rates

CHAIR ERCHINGER explained MR. WEST requested the information in attachment 1 be presented in this format. She agrees the material clearly communicates the current plan and the proposed recommendations. MR. WEST likes the format.

MR. JOHNSON asked Buck to respond to the statement made on page four of the GRS review regarding the investment return assumption; "Buck states that 'we believe the current investment return assumption of 8.00% could be maintained. However, the ARMB may decide to adopt something less than 8.00% to reflect a margin for adverse deviation.'" MR. KERSHNER reviewed the process Buck conducted with the Board in showing the different economic models and outlook approaches regarding a range of reasonable return assumptions based on supportable expert opinions. The 8% return assumption reflects the Approach 1 modeling of historical norms and is supported by expert opinions. Approach 1 is an outlier in today's public plan universe. The differences in the approaches are varied by the spectrum of expectations and comfort levels. The ARMB must believe in and be comfortable with the approach chosen for the investment outlook.

COMMISSIONER QUICK invited MR. KERSHNER to expound on the data in support of an 8% return expectation for the plan. MR. KERSHNER noted the future expectations are based on the projected future returns of the plan's asset allocation and underlying capital market assumptions. The modeling used shows a reversion to historical norms over the long-term and supports an 8% return based on the analysis. COMMISSIONER QUICK asked if an 8% return expectation is reasonable and responsible. MR. KERSHNER explained the actuarial world is gray, rather than black and white. He believes an 8% return is overly optimistic. The risk of not earning 8% is significantly higher now than it was in the past. Adding a layer for adverse deviation to protect against that risk is appropriate. Lowering the assumption is a reasonable decision.

CHAIR ERCHINGER commented it would be useful for the tables to show the actual historical experience of the assumptions alongside the current assumptions and the proposed assumptions. MR. KERSHNER noted the detailed experience study report does show the historical experience data. CHAIR ERCHINGER emphasized the decision to change the total investment return assumption was based on derisking and decreasing the inflation rate from 3.12% to 2.5%, and not because of peer pressure or political influence.

CHAIR ERCHINGER requested Buck address the outstanding items not mentioned in the experience study referenced on page two of the GRS executive summary. MR. KERSHNER advised some of the items have already been addressed. He informed Buck did reference other measures in the experience study report regarding the inflation assumption, including the expert opinions of the Philadelphia Fed, the Social Security forecast, and other long-term forecasts. The population growth assumption has been addressed during recent presentations. The TRS withdrawal rates for females at ages 62, 63, and 64 were raised slightly because the experience of teachers of those ages was modestly higher than the current assumptions. The TRS withdrawal rates for males of those ages were not increased because the data did not support the action. All of the withdrawal rates for the DCR members were raised because the DCR experience was higher than the current assumption. Buck issued and provided a draft report to staff with this information, which can be finalized at the Committee's request. CHAIR ERCHINGER believes the final report would be helpful.

MR. KERSHNER reviewed the second attachment, which collects the information provided at previous meetings regarding considerations in setting the healthcare trend rates, including the evaluation of the current trend rates and the reasons for the proposed changes. Attachment 3 was developed largely due to requests by COMMISSIONER FISHER at the September meeting regarding the impacts of the assumption changes on the actuarial liability. MR. KERSHNER explained each of the columns and showed the isolated impact of the proposed trend rate changes.

MR. KERSHNER described Attachment 4, which is a summary of the unfunded accrued liability amortization method relative to other closed plans. The information provided is based on publically available information. The outlined best practice considerations and guidance for closed plans was issued in 2014. Closed plans are in the minority in the public sector, but are in the majority in the private sector. It is common for plans to change the level of benefit accruals through tiers for later hires.

MR. KERSHNER explained Attachment 5 in detail. It delineates the projections of the employer and additional State contributions to the PERS and TRS DB plans using the FY20 contribution rates adopted at the September meeting under three scenarios. Scenario 1 reflects the current methods and assumptions. Scenario 2 reflects the proposed methods and assumptions from Attachment 1 based on the modeled payroll figures. The actual contributions will be based on yearly payroll experience. Scenario 3 reflects the same assumptions and methods included in Scenario 2, with the addition of the 25-year layering procedure beginning June 30, 2018. MR. JOHNSON informed STUART GOERING, Assistant Attorney General, will expound on the possibilities of layering later in the meeting.

MR. KERSHNER reported Attachment 6 delineates the DB normal costs as a percentage of the DB payroll figures and the DCR normal costs as a percentage of the DCR payroll figures for PERS and TRS as of June 30, 2017. This informational format is not part of the experience study. It was requested to be provided at the previous meeting.

MR. WILLIAMS expressed appreciation to MR. KERSHNER for being responsive to the requests for information communicated at the prior meeting.

2. **Action: Relating to Acceptance of Experience Study Actuarial Assumptions**
   Resolution 2018-19

CHAIR ERCHINGER suggested action on Resolution 2018-19 be delayed until a meeting in January, in light of the new Administration and new Trustees. This would allow the new Trustees to fully review the information that would impact the FY21 budget. CHAIR ERCHINGER asked for feedback regarding potential effects of a delay on the actuarial timeline and deliverable schedule. MR. KERSHNER advised the June 30, 2018 valuations will be used to set the FY21 contribution rates in September of 2019, regardless of the timing of the adoption of the assumptions. Buck has been in communication with GRS regarding the previous three-month delay. An added one-month delay will strain the tentative scheduled presentation of the draft valuation results in May and the final report adoption in September.

MR. WEST recognized it may be out of order to adopt the resolution at this meeting, given the implications of Scenario 3 have not yet been discussed for consideration. CHAIR ERCHINGER explained her assumption, given the timeframe, was the new assumptions could be adopted with the current amortization schedule, and the amortization that included layering could be introduced next year. MR. WEST advised the resolution, as it is written, is too general and does not specify what assumptions are being adopted. He believes the resolution should clearly state the recommended assumptions.

MS. HARBO moved to table acceptance of Resolution 2018-19 until a yet to be determined date in January 2019. MR. WEST seconded the motion.

A roll call vote was taken, and the motion passed unanimously.

VIII. LIABILITY LAYERING REVIEW/ DISCUSSION

CHAIR ERCHINGER requested MR. GOERING proceed with the liability layering review and discussion. MR. GOERING conveyed the ARM Board asked for legal advice during the September 2018 meeting regarding layered amortization of past service liability. MR. GOERING prepared a memorandum and requested the actuaries remain during the presentation to provide comments. MR. GOERING could make any necessary revisions of the memorandum based on comments and present the revised memorandum to the full Board at tomorrow's meeting.

MR. GOERING stated the responsibility for implementing the statute is shared between the ARMB and the Commissioner of the Department of Administration, as the retirement system administrator. Likewise, the interpretation of the statute should be a shared responsibility coordinated between the administrator and ARMB.

MR. GOERING found the ARMB and the administrator may rely on an actuarial valuation of accrued liabilities using layered amortization. Both historical practice and the statutory language are most consistent with a 25-year amortization period. Any other amortization period is not consistent with historical practice and not consistent with statutory language.

MR. GOERING explained the guidance for interpreting the statute and the basis for the memorandum. The relevant codified language is the last clause in AS 37.10.220(a)(8)(B), which was added by HB 385 during the 2014 session. Additional relevant uncodified language was included as a transition provision in the bill and should be considered together. Codified language and uncodified language are both law and create enforceable rights and obligations. Intent language is the Legislature's suggestions about how a law should be implemented. The Legislature explicitly directed to revert to a level percent of pay method in both codified and uncodified language of HB 385.

MR. GOERING noted although the term "layered" was not used in HB 385, it is reasonable to imply the legislative intent was to continue use of layered amortization because that was the historical practice and there was no explicit statutory direction or legislative history to indicate layering was to be discontinued. The codified language, as expected, uses the generic descriptive term of "amortization" for a closed term of 25 years. The uncodified transition language states the amortization "for a term beginning July 1, 2014, and ending June 30, 2039." MR. GOERING explained one key statutory interpretive principle is that an interpretation should not render any portion of law surplus, which favors an interpretation of the codified language as layered as opposed to fixed. MR. GOERING described the transition language requires the ARMB to "reinitialize" the amortization of past service liability, which was the 25-year layered amortization process.

CHAIR ERCHINGER respectfully disagreed with MR. GOERING's interpretation. She does not object to using a layered approach, but reads the statute differently. MR. GOERING expressed the decision is within the discretion of the ARM Board and Commissioner of the Department of Administration.

MR. GOERING added HB 385 did not eliminate the requirement that the determination of system assets, accrued liabilities, and funding ratios are to be based on an actuarial valuation and must still be reviewed by another actuary who is a member of the American Academy of Actuaries. The implication is the actuaries will be applying their usual and accepted standards. Layering appears to be the standard actuarial method based on both pre-2014 historical practice and recent presentations by the State's actuaries.

MR. GOERING examined the existing ambiguity because the word "layering" is not included and the term "closed term" is included, which could be considered synonymous with "fixed." He explained the more likely meaning of "closed" is each layer is closed in the sense that subsequent changes in past service liability are amortized over a new 25-year term, rather than by adjusting the amortization attributable to a prior period. This prohibits so-called rolling amortization and is consistent with other interpretive factors in favor of amortizing past service liability over a layered 25-year period.

MR. KERSHNER commented there is more than one standard actuarial practice. The layered amortization approach currently recommended is considered the preferred actuarial practice because of the ability to minimize volatility in contributions, especially as the period of amortization decreases in length. MR. KERSHNER agrees it is preferable to use the layered amortization approach.

MR. GOERING described his analysis included review of legislative history, speaking with persons in the Department of Administration and the Governor's Office, and receiving insight on discussions and interpretation by the Legislature during the creation of HB 385. The information collected is supportive of MR. GOERING's conclusion the ARM Board may use layered amortization as recommended by the actuaries.

In the event the ARM Board wants to utilize layering, but the ARMB interprets the statute as prohibiting layering, MR. GOERING recommended communicating with the Governor's Office to develop a bill to change the statute so it is beneficial for the retirement systems.

MR. WEST suggested if the legislative route is chosen, the 25-year period should also be addressed. He feels the 25-year period is an excessive timeframe.

MR. JOHNSON requested MR. KERSHNER provide additional information regarding the 25-year period. MR. KERSHNER discussed it is actuarially acceptable to change the layering period to shorter than 25 years, and it is actuarially possible to use different periods for different circumstances, such as gains and losses or changes in assumptions. He believes the amortization period should be shortened as the plan evolves and there are no longer active members.

MR. GOERING clarified that prior to 2014, the ARMB could use any period of time for layering recommended by the actuary. The Legislature codified the existing practice as to the 25-year layered amortization and directed a reversion back to level percent of pay. If the Legislature had not included the 25-year period in the codified portion, the ARMB would continue to have the discretion to set other layering amortization terms.

CHAIR ERCHINGER commented future Trustees and the future Legislature who are serving at the time the plan has very few active members will have to address the fundamental changes in volatility, intergenerational equity, and contribution rates because the plan is closed.

MR. GOERING does not believe revision to the memorandum is required, based on the comments received today. The memorandum is available to be distributed.

CHAIR ERCHINGER expressed appreciation to attendees for persevering through the challenges and tension the Board faces to plan for sufficient resources to meet beneficiary payments, respecting the State's tremendous financial pressure.

IX. FUTURE MEETINGS

A. Calendar Review

CHAIR ERCHINGER noted the calendar is in the packet. An additional meeting will be scheduled in January. She requested the Committee be flexible, as adjustments to actions may be necessary based on delaying the approval of the actuarial experience study.

B. Agenda Items - None.

C. Requests / Follow-Ups - None

X. ADJOURNMENT

MS. HARBO moved to adjourn the meeting. MR. WEST seconded the motion. The motion passed without objection.

The meeting was adjourned at 12:30 p.m.

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