State of Alaska
ALASKA RETIREMENT MANAGEMENT BOARD
ACTUARIAL COMMITTEE MEETING

Videoconference

MINUTES OF
March 17, 2021

Wednesday, March 17, 2021

ATTENDANCE

Committee Present: Allen Hippler, *Chair*
Lorne Bretz
Gayle Harbo
Rob Johnson
Commissioner Mahoney
Commissioner Tshibaka (Late)
Bob Williams

Committee Absent: None

ARM Board Trustees Present: Lorne Bretz
Donald Krohn
Dennis Moen

IAC Members Present: Ruth Ryerson

Department of Revenue Staff Present:
Zachary Hanna, Chief Investment Officer
Pamela Leary, Director, Treasury Division
Mike Barnhill, Deputy Commissioner
Shane Carson, State Investment Officer
Scott Jones, Head of Investment Operation, Performance & Analytics
Grant Ficek, Business Analyst
Alysia Jones, Board Liaison

Department of Administration Staff Present:
Ajay Desai, Director, Division of Retirement and Benefits
Kevin Worley, CFO, Division of Retirement and Benefits
James Puckett, Deputy Director, Division of Retirement and Benefits

Department of Law:
Stuart Goering, Assistant Attorney General, ARMB Legal Counsel

Rob Schmidt, Assistant Attorney General

Others Present:
David Kershner, Buck
Scott Young, Buck
Tonya Manning, Buck
Ric Ford, Gabriel Roeder Smith
Paul Wood, Gabriel Roeder Smith
Bill Detweiler, Gabriel Roeder Smith

I. CALL TO ORDER

CHAIR HIPPLER called the meeting of the ARM Board Actuarial Committee to order at 1:00 p.m.

II. ROLL CALL

MR. BRETZ, MS. HARBO, MR. JOHNSON, COMMISSIONER MAHONEY, COMMISSIONER TSHIBAKA, MR. WILLIAMS, and CHAIR HIPPLER.

III. PUBLIC MEETING NOTICE

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

IV. A. APPROVAL OF AGENDA

<u>MS. HARBO moved to approve the agenda.</u> <u>MR. WILLIAMS seconded the motion.</u> The agenda was approved without objection.

B. APPROVAL OF MINUTES: December 2, 2020

<u>MS. HARBO moved to approve the minutes of the December 2, 2020 meeting.</u> <u>MR. WILLIAMS seconded the motion.</u> The minutes were approved without objection.

V. PUBLIC/MEMBER PARTICIPATION, COMMUNICATIONS & APPEARANCES - None.

VI. BUCK UPDATES

A. Complete 6/30/2020 Valuation Results

MR. KERSHNER said that he would touch on key points of the PowerPoint presentation but had also provided a detailed memo to supplement the PowerPoint presentation, as well as draft valuation reports for all of the plans. He said that they had tried to respond to questions, comments, and suggestions for additional information in the content of the presentation. He also explained the baseline projections based on the 2020 valuation results were being provided, so that the board had the most recent projections.

MS. MANNING gave an overview of the process Buck takes to provide the results of the actuarial valuation process. She said the information they received was put into models that form the results of what was presented to the Board. She further explained the information contained in the data that created the models. She said the information included participant data which was a large part of what they used to analyze in order to provide liability calculations. She said they also used market value of assets which enabled them to understand how much had been put aside for the plan. She said they also used projected benefits and applied assumptions which showed potential increases in salaries, potential dates of retirement, among other things, and the projected longevity or estimated mortality of participants.

MS. MANNING said that on the asset side, they looked at how the assets might perform in the future. She said they looked at possible performance of assets in the future and made assumptions as to how the return would be on the assets. She explained that although the American Rescue Plan Act did have provisions that affected retirement plans, because the plan the ARM Board oversees was a public plan, it was not affected.

MR. KERSHNER explained that the referenced memo was located on page 17 of the packet, the PowerPoint presentation started on page 25, the draft valuation timelines started on page 123, and the preliminary timeline for the experience study was on page 500.

MR. KERSHNER explained that the asset experience for FY2020 was unfavorable because the market return for year ending June 30, 2020 was below the expected return of 7.38 percent. He said Buck had calculated the market return to be 4.1 percent which was a simplified calculation that many actuaries used that assumed all cash flows were evenly distributed. He said the actual market return produced a loss of $556 million for PERS and $274 million for TRS. He said to smooth out the effects of the market gains and losses over a five-year period, they used an actuarial value of assets. He pointed out a footnote that referred to deferred asset losses that had not been recognized in the actuarial value - $420 million for PERS and $210 million for TRS. He said those market losses would be recognized over the next one to four years. He stated that the losses were reflected in the contribution projections.

MR. KERSHNER said the experience was favorable for the liability side. He said they calculated what they had expected the liabilities to be as of June 30, 2020 based on the last year's figures and what they had expected to happen during the year, they compared the expected values with the newly calculated liabilities. He said for both pension and healthcare the liabilities were less than expected, PERS had a gain of $441 Million split between pension and healthcare, and TRS had a $154 million liability gain split between pension and healthcare.

MR. KERSHNER stated that the gain achieved by pension was due to inflation increases, however it was less of an increase than expected which had an impact on elements that drive pension liabilities. He said lower inflation had affected the PRPA (Post-Retirement Pension Adjustments) which are linked to CPI increases.

MR. YOUNG said that the healthcare gains were attributed to the new prescription drug contract with Optum; those gains were producing lower liabilities.
MS. HARBO asked if the EGWP helped; MR. YOUNG said the EGWP lowered the liability, which was previously reflected.

MR. KERSHNER explained that they had $441 million in liability gains for PERS compared to a $275 million smoothed asset loss made the PERS unfunded liability $166 million lower.

MR. WILLIAMS asked if it was correct that the overall comparison of losses to gains that the chart presented, showed a loss; MR. KERSHNER confirmed that was the case. MR. WILLIAMS went on to ask if they would continue to see reduced liability; MR. YOUNG interjected saying they were phasing in the new contract with Optum and what they saw was the lower experience from the more favorable pricing. He said they were recognizing it over time as it was coming through and used that as a basis for projecting forward.

MS. HARBO asked if they were going to see a gain in medical claims for the second half of 2020 as the first half of 2020 had fewer claims since people were not going to see their doctor; MR. YOUNG said that they had accounted for that and had made an adjustment of what they expected the future medical costs to be. He said they did not expect a significant change or spike over the long term.

MR. YOUNG explained that as of June 30, 2020, the liability for healthcare benefits expected to be received in the future was approximately $7 billion. He provided a breakdown for pre-65 and post-65. He said for pre-65 the amounts were $400 million for prescription drugs and $1.7 billion for medical benefits. He said the benefits for post-65 was split more evenly and that the medical and prescription drug combined was approximately $5 billion, or 70 percent of the total. He said that TRS had similar relationships as they had the same plan designs and cost assumptions, however the ratios were different due to different populations in TRS versus PERS.

B. 2020 Valuation Projections

MR. KERSHNER said an important element to the projections was they were assuming that the experience would match the assumptions they were predicting. He said that since the healthcare trusts were over 100 percent funded, they assumed 100 percent of all future additional state contributions would be deposited to the pension trusts.

MR. KERSHNER said that Slide 14 showed the additional state contributions projected starting in FY2023 for PERS with detailed numbers year-by-year on Slide 16. He said FY2023 started at $196 million and would reach its peak in FY2039 of just under $318 million. He said after that point, the contribution rates were much lower because they would have fully funded that liability. He said that additional state contributions for PERS was projected to be zero after 2039 because the total contribution rates for those years would be less than the 22 percent employer contribution unless the statutes were changed.

MR JOHNSON asked if MR. KERSHNER was taking into account the prospect of SB55 passing or not passing; MR. KERSNHER said they had not reflected anything related to SB55.

MR. JOHNSON asked if the bill passed, if that would have an effect going forward; MR. KERSHNER said that he was correct, that SB55 is a shifting of obligations between additional state contributions versus employer contributions for the employees.

MR. KERSHNER explained that Slide 15 showed the total funded ratio for PERS. He said because they had liability gains that had not been anticipated in the September projections, they were anticipating the pension and healthcare combined, to reach 100 percent funded status on an overall basis two years earlier than was projected in September. He said for the next 16-to-17-year period, they were projecting $170 million less in additional state contributions for PERS.

MR. KERSHNER said TRS would have a few more years of contributions, including the DCR contribution rate that was projected to be slightly higher than 12.56 percent. Once the contributions go below 12.56 percent it would become zero.

MR. KERSHNER explained that Slide 18 showed the comparison of the current funded ratio versus the information provided in September, they had anticipated reaching 100 percent funded status two years earlier.

C. Sensitivity Analysis

MR. KERSHNER stated that based on actual experience, they were not expecting future gains or losses in their projections. He said they had identified two risk factors that appear to have the largest impact on contributions and liabilities, which were asset returns and medical and prescription drug costs. He also explained that the baseline scenario assumed earnings of 7.38 percent return each year and that medical and prescription drug costs would increase per assumed trends. He presented to alternatives that represented adverse experience scenarios to illustrate the sensitivity of the numbers.

MR. KERSHNER explained that Slide 23 was a graph of the increase in the additional state contributions due to the potential adverse asset returns. The graph showed that they were generating an $812 million total asset market loss over a two-year period and that generated a $630 million increase over the same period of time in additional state contributions. He said that the bottom line was that two bad years of asset returns without any future returns to make up for the losses could generate sizeable increases in contributions to the plans. He explained that an adverse medical experience with two bad years were still projected to be above the 100 percent funded status for the healthcare trusts. He explained that the difference in the scenarios was due to the assumption that the additional state contributions were going to the pension trusts, and that the higher additional state contributions help improve the pension funded status.

D. Historical Comparison

MR. KERSHNER explained that the historical comparison showed how their outlook evolved over time. He said they chose 2015 because that was the year the state contributed $1 billion higher additional contributions to PERS and $2 billion to TRS. He noted the outlook for 2018 had a dramatic change when they changed the assumptions and reflected the implementation of EGWP.

MR. KERSHNER explained that as the population ages and moves into retirement, the existing retirees would begin to die and ultimately the liabilities would reach a maximum amount and then decline to zero. He said they were projecting that by 2040 the liabilities would be just under $13 billion, which was half a billion less than what they were predicting based upon the 2015 outlook.

MR. KERSHNER said payroll contributions were assumed to increase, but over the last six years the actual salary increases had not been what they had expected. He said a much lower projected payroll would lead to higher contribution rates if everything else was the same. He explained that in the past six years there were asset losses that generated an additional $125 million of higher contributions and $230 million lower because of the favorable claims experience, the implementation of EGWP, and the new prescription drug claims administrator. He stated that on June 30, 2016 they introduced the rehire load which caused contributions to increase greater than expected.

E. Valuation Timeline/Experience Study Timeline

MR. KERSHNER explained that based on the pattern of assumptions, they expected new assumptions the Board adopted would be effective beginning with the 2022 valuations, as there is one more year on the 2021 existing assumptions. He said in December they anticipate discussing economic assumptions and any proposed changes to those assumptions. He said in March of 2022 they will discuss the proposed changes to the demographic assumptions and combine those with economic assumptions that would have been discussed in December, and at the June 2022 meeting they would discuss any follow-up adjustments to what had been discussed at the two prior meetings. He said at that point the Board would be in position to adopt the new assumptions to be effective with the June 30, 2022 valuations.

F. Draft 6-30-2020 Valuation Reports

MR. KERSHNER stated that the draft June 30, 2020 valuation reports for all six plans were included in the Board packet and they had also been provided to GRS and all had been reviewed except the JRS Plan and the National Guard Plan, which had only just been provided two weeks prior.

VII. OPTION OF PRE-RECORDED PRESENTATION BY ACTUARY

CHAIR HIPPLER explained the option of a pre-recorded presentation. He said that in their review of the charter and what the committee does and how it interacts with the ARM Board, they had looked at options to make the meetings more effective. He said one option was to have the actuaries pre-record their presentations to guide the Board's understanding of the large packets they receive, so they could listen to the presentation ahead of the meeting.

MR. JOHNSON commented that he saw two downsides to the idea. He said the first would be the beneficiaries that join the meetings would have to have the recording made available to them for transparency. He said the second downside to a pre-recorded presentation would be the lack of the ability to ask questions and engaging in discussions.

MS. HARBO wondered if CHAIR HIPPLER had discussed the idea with Buck. She stated that she digests the discussions after the meeting by reading the minutes as a refresher as to what had been asked and how questions were answered; CHAIR HIPPLER said that it had not been his intent to shorten the meetings except in the presentations to the Board. He said the entire presentation would be provided at least a week in advance so the Trustees would have time to listen to the presentation as it guided them through the packet.

MR. KERSHNER commented that they had been considering ways to improve the usefulness of the meetings such as preparing the memo and giving the Board details in advance of the meeting to assist in further understanding how the numbers work and what the slides meant. He said that would be the intent of the pre-recorded presentation.

CHAIR HIPPLER said that it was not put on the agenda as an action item, but as a discussion item for ideas as to what direction the Board would like to go. He said he did think that there was potential to have a more digestible walk-through format ahead of the meetings to assist in understanding the material.

MR. JOHNSON said that the memorandum in advance along with the initial presentations would be helpful and lead to a more fine-tuned presentation.

MS HARBO commented that before the Actuarial Committee existed, the information was presented in the Board meeting; the Actuarial Committee was formed to keep the Board meeting from being so long.

VIII. DRAFT REVIEW RESULT AND RECOMMENDATIONS

MR. WOOD presented the preliminary results of their review of the June 30, 2020 actuarial valuation. He said based on the data, they had a favorable claims experience where the per capita claims costs did not increase as much as they had expected. He said Medicare Part A and B, however, did have increases slightly higher than what was expected. He said prescription drug costs had been predicted to increase by 8 percent, where they actually saw a decrease to negative 4 percent. He said they had found the adjustments Buck had made to the claims differences due to the pandemic reasonable and had discussed them with their OPEB experts and had made similar adjustments on their end and would continue to monitor going forward.

MR. WOOD then moved on to discuss the review of the assumptions. He said they look at the gains and losses generated each year. He said they currently had two years of experience under the most recently adopted assumptions that would enable them to monitor developing trends. He said a trend that began showing up was with the Medicare Part B assumption causing consistent gains and noted that it may come up as Buck moves into the experience study process later this year.

MR. WOOD said the investment return would continue to be watched as there was a downward trend across the country. He said NASRA (National Association of State Retirement Administrators) does a public fund survey every year that indicates a median return across all public sector plans of 7.23 percent, which was lower than the Boards 7.38 percent. He said that he was not suggesting that the rate of return would need to come down because others were experiencing a lower rate. He said he would not be surprised to see recommendations to move the percentage rate down to keep in line with shifting expectations in the capital markets.

MR. WOOD said the plans were different between DB and DCR on the healthcare side. He said in the past they had not been able to validate the relative value assumption, but as they worked with Buck, they had been provided the necessary information to validate the assumption and certify that they are reasonable.

MR. WOOD explained that they perform a test life review or sample life audit where they took a sample of people and compared the data that was used by Buck in their valuation and looked at the benefit amounts and the liability calculations for each of the samples. He said those samples show if the assumptions were being employed correctly. He said they choose different test lives each year and in the years where there are no assumption of plan changes, they look for members with unique characteristics that may show them something hidden.

MR. DETWEILER presented the five findings and noted that impact of the liabilities was either minimal or no impact. He said Finding 1 & 2 were related to disability. He explained Alaska COLA showed a 10 percent increase in benefits that recipients who are Tier 1 members and still lived in Alaska received. He said Tier II and III members do not receive COLA until they turn 65 with the exception of members who are on disability, the 10 percent increase would start immediately regardless of age and tier. He said they received a TRS Tier 2 member who was under the age of 65 and retired from disability. He said they noticed that Buck had not applied the COLA until the member turned 65. He said that it should have been applied immediately so they recommended Buck to review and make sure COLA is applied immediately for any member in that category.

MR. DETWEILER said peace officers/firefighter members that are in DCR and DB plans have a special provision if they were on disability and became eligible for retirement. He said any accumulated PRPA percentage that had been applied to the disability benefit, the same percentage would be applied to their regular retirement benefit. He said Buck had applied the cumulative percentage increase to members in the DCR Plan, but not to the peace officer/firefighter members in the DB Plan. Their recommendation to Buck was to make sure the information was being modeled correctly across both plans.

MR. DETWEILER said Finding 3 was related to a slight inconsistency in decrements used in Buck's reports and modeling. They recommended Buck verify that all of the rates in their reports match what they are modeling in their valuation. He said the fourth finding was related to early retirement factors for TRS and JRS and recommended that they provide more detail on exactly what assumptions are being used for those factors. He said the fifth finding was within the National Guard Plan. He said they noted Buck was incorrectly valuing the death benefit in some instances, and recommended they adjust the basis for the death benefit amounts.

MS. HARBO asked a question regarding the COLA issue. She asked when they come up with a recommendation such as this, does DRB go back and find the people affected and make adjustments; MR. WOOD said that they did not believe the findings would impact the actual payment of the benefits, that it was how the benefits were being valued and projected in the valuation.

IX. REVIEW OF ACTUARIAL COMMITTEE CHARTER

CHAIR HIPPLER explained that a draft charter had been approved by the committee a few years ago, but that additional changes needed to be made following legal review. He said those revisions had been incorporated and the updated charter was being presented to the committee for consideration. He said it seemed straightforward and if they were ready, he was open to recommending the ARM Board adopt it as the charter for the Actuarial Committee and a motion to approve it.

<u>MS. HARBO moved to adopt the charter for the Actuarial Committee.</u> <u>MR. JOHNSON seconded the motion.</u> The recommendation was approved without objection.

X. REVIEW ACTUARY

MS. LEARY said they had two action items to review. The first was the GRS contract that runs from July 1, 2017 to June 30, 2021 with two optional one-year extensions. She said they had already approved one extension and the action item was to approve a second one-year optional extension through June of 2022. She said the recommendation would be for the ARM Board Actuarial Committee to recommend to the full Board that staff exercise the second one-year contract through June 30, 2022.

MS. HARBO moved for the approval of the extension. MR. JOHNSON seconded the motion. The motion passed unanimously.

XI. ARMB ACTUARY AUDIT CONTRACT

MS. LEARY said the second action item was for the third actuary to perform the once-every-four-years audit. She said they sent out a request for interest on February 12th with a closing date of March 1st. They had received two responses and a submittal from GRS explaining their history and a fee to conduct the work. After a staff review, they determined it was in the best interest of the beneficiaries of the pension system to recommend GRS.

MS. HARBO moved for the approval of the extension. MR. WILLIAMS seconded the motion. The motion passed unanimously.

MS. HARBO reminded the committee of the independent audit by Milliman that discovered Mercer had underestimated the cost of healthcare which cost the retirement systems $3 billion.

MR. WILLIAMS requested a roll call vote.

MR. JOHNSON said that he felt there should be language in the motion "for the reasons set forth in previous discussions and the memorandum dated today."

CHAIR HIPPLER confirmed that MS. HARBO as maker of the motion and MR. WILLIAMS as second, concurred with MR. JOHNSON's amendment.

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

XII. FUTURE MEETINGS

A. Calendar Review – None

B. Agenda Items – None

C. Requests/Follow-Ups – None

X. PUBLIC/MEMBER COMMENTS - None.

CHAIR HIPPLER asked if any trustees cared to comment; MR. MOEN commented that it had been a great meeting full of a lot of good information and that he had appreciated it.

XI. ADJOURNMENT

<u>MS. HARBO moved to adjourn the meeting.</u> <u>MR. WILLIAMS seconded the motion.</u> The motion passed without objection.

The meeting was adjourned at 3:18 p.m.

ATTEST:

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Corporate Secretary

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