MINUTES OF THE MEETING
OF THE
ASSEMBLY COMMITTEE ON GOVERNMENT AFFAIRS

Seventy-Fourth Session
February 13, 2007

The Committee on Government Affairs was called to order by Chair Marilyn K. Kirkpatrick at 8:01 a.m., on Tuesday, February 13, 2007, in Room 3143 of the Legislative Building, 401 South Carson Street, Carson City, Nevada. Copies of the minutes, including the Agenda (Exhibit A), the Attendance Roster (Exhibit B), and other substantive exhibits are available and on file in the Research Library of the Legislative Counsel Bureau and on the Nevada Legislature's website at www.leg.state.nv.us/74th/committees/. In addition, copies of the audio record may be purchased through the Legislative Counsel Bureau's Publications Office (email: publications@lcb.state.nv.us; telephone: 775-684-6835).

COMMITTEE MEMBERS PRESENT:

Assemblywoman Marilyn Kirkpatrick, Chair
Assemblywoman Peggy Pierce, Vice Chair
Assemblyman Kelvin Atkinson
Assemblyman Bob Beers
Assemblyman David Bobzien
Assemblyman Chad Christensen
Assemblyman Jerry D. Claborn
Assemblyman Pete Goicoechea
Assemblyman Ruben Kihuen
Assemblyman Harvey J. Munford
Assemblyman Bonnie Parnell
Assemblyman James Settelmeyer
Assemblyman Lynn D. Stewart
Assemblywoman RoseMary Womack

STAFF MEMBERS PRESENT:

Amber Joiner, Committee Policy Analyst
Emilie Reafs, Committee Secretary
Olivia Lloyd, Committee Assistant

OTHERS PRESENT:

Leslie A. Johnstone, Executive Officer, State of Nevada, Public Employees' Benefits Program
Jon M. Hager, Chief Financial Officer, State of Nevada, Public Employees' Benefits Program
Terry L. Hickman, Executive Director, Nevada State Education Association
James T. Richardson, J.D., Ph.D. Nevada Faculty Alliance
Martin Bibb, Executive Director, Retired Public Employees of Nevada
Danny Coyle, President, Retiree Chapter, State of Nevada Employees Association, AFSCME/Local 4041
James R. Wells, CPA, Deputy Superintendent, Administrative and Financial Services, State of Nevada, Department of Education
Marvin Leavitt, Chairman, Committee on Local Government Finance

[8:01 Called to order, Roll Call]

Chair Kirkpatrick:
Thanks to everyone for being on time. All members are present. We have a little bit of housekeeping that we need to do before the presentations. The first order of business this morning is to introduce BDR 18-772, which was requested by Mr. Parks, the former chairman of Government Affairs. It is on behalf of the Reno-Sparks and the Las Vegas Convention and Visitors Authorities.

BDR 18-772—An act relating to the Commission on Tourism, making certain ex officio nonvoting members of the Commission voting members; and providing other matters properly relating thereto. (**Assembly Bill 101**.)

Chair Kirkpatrick:
This measure would revise provisions governing the Commission on Tourism. Remember that if you vote in favor to introduce it, it does not mean that you support it, just that we will have a discussion.

ASSEMBLYWOMAN PIERCE MOVED TO INTRODUCE BDR 18-772.

ASSEMBLYMAN GOICOECHEA SECONDED THE MOTION.

THE MOTION CARRIED.

Chair Kirkpatrick:
We would like to thank Ms. Johnstone for coming back and for the presentation yesterday. Today she will be doing an overview of the unfunded liability. I will let you introduce yourself. I wanted to let the Committee know that it is important to ask a lot of questions. Today we have an extra hour, and then we will take public comment at the end.

Leslie A. Johnstone, Executive Officer, State of Nevada, Public Employees' Benefits Program:
Before I get started on the Governmental Accounting Standard Board (GASB) overview, I want to make one clarification to an answer I gave yesterday regarding the voluntary life product that is available to non-state retirees. I answered that it was available to all non-state retirees, and I need to clarify that the voluntary life is not available to state or non-state retirees who reinstate during the late open enrollment every other year. It is available to state and non-state retirees who join Public Employees' Benefits Program (PEBP) upon retirement, but if they come in at a later time, then they are not eligible for the voluntary life product.

[Accompanied by PowerPoint presentation, (Exhibit C)] Today's topic is the Governmental Accounting Standard Board Statement (GASB) 43 and 45, which is the regulation or rule set by the accounting body that we follow, which outlines how the program and how any governmental entity is to recognize any liability for retiree benefits other than pensions. Those have been previously addressed and so statements 43 and 45 by GASB speak just to non-pension retiree benefits.

[Slide 2] Statement 43 establishes uniform reporting standards but it applies to "plans," and I put plans in quotations on purpose, that are before July 1st of 2007. In that we do not put our program in a trust fund and it does not meet the other definitions of a plan, it does not fall under the requirements for statement 43. We are focused on GASB statement 45, which for a plan our size, takes effect for fiscal year 2008, so July 1, 2007, will be our starting point. It establishes the standards for measuring and recognizing any unfunded liability of the retiree benefits. I am going to go through several definitions. There are a lot of acronyms attached to this issue, and I want to go through those so that the Committee members are familiar with them.

Statement 45 outlines what note requirements are established for the statewide financial statements and what supplementary information is required. To be clear, the requirements are not on the State as the employer, and so they will show on the comprehensive annual financial statements. The liability itself is not recorded at the PEBP level. It is recorded on the statewide financial statement.

[Slide 3] The OPEB is the first acronym that you will hear a lot, and that is because the title of this is "other post employment benefits" (OPEB). That means retiree benefits other than pensions, so for all intents and purposes with our program, that means health care, medical, dental, and vision programs that are included. That also includes our life insurance and disability programs. What is not included in OPEB are any of the early retirement inducements that may be in place or any conversion of sick leave to account for the OPEB.

[Slide 5] The Governmental Accounting Standards Board established this because they saw a shortfall in recognizing this liability and wanted full disclosure on governmental financial statements of what benefits had been obligated. The new rules specify how we will record any shortfall between our current funding mechanism, which we will refer to as "pay-as-you-go" and pre-funding. Each biennium the State appropriates the subsidy on behalf of the retiree participants required every biennium. There is not an additional amount that is appropriated toward any other future liabilities, and so that is referred to as "pay-as-you-go." The statement requires us to change to a full accrual method of accounting for this cost. This is similar to what the private sector went through many years ago, I think twenty years ago plus, in the Financial Accounting Standards 106 statement, and it is very similar to what the pension program needs to go through when it is recording its liability for benefits that have already been earned.

[Slide 6] Very simply, the impact on the statewide financial statements is that currently we record our expenses exactly equal to what we provide for the retiree subsidy for the current year. Under GASB, it does not impact the governmental fund financial statements, but it will impact the government-wide financial statements. We will show the full cost of benefits, which I will get into in a minute, which will be referred to as the Annual Required Contribution (ARC). It will record a liability for any amount of that Annual Required Contribution that is not funded, so it is the difference between the liability and what has actually been set aside to fund that liability.

[Slide 7] There are some misconceptions about how we have to implement these statements; one is that advanced funding of the OPEB liability is required, so even though I will refer to an Annual Required Contribution, it is not technically required. It is just the label that has been given to the value of the liability that must be recorded, or the expense that must be recorded. The other misconception is that OPEB will wipe out the General Fund balance and that is not the case. It will impact the statewide financial statements by way of recording that liability, but it does not directly impact the General Fund. The third misconception is that the government will have to report a liability for OPEB earned previously. The fourth item is that no written agreement means that there is no OPEB. In our case, without union relationships with the employees, we technically do not have a written agreement with our employees that the State will provide certain funding. What we do have is a long-standing precedent of doing that. The statement will look toward that. While it is not referred to as a contract, the statement will look to previous practice as the reason that we reasonably assume it would continue. The final misconception is that no OPEB exists if retirees pay their full health care premium, and I will get into that in a minute. It has to do with the commingling and the implied versus the explicit subsidy that is provided to the retirees under our current plan structure.

[Slide 8] Three things to remember, that we think are important, is that the State of Nevada is not alone in this, all governmental entities are working through these same issues. Another item is that the dollars must go to a trust fund to count as pre-funded. So unless we establish a trust fund, any dollars set aside for pre-funding do not offset that liability when we are putting our financial statements together. As we talk about the Governor's proposal to include $25 million in each year of the biennium, part of the implementation of that recommendation will be a Bill Draft Request (BDR) to establish an irrevocable trust fund so that it will count towards the amount pre-funded. No liability on the financial statement will be recorded if we fully pre-fund the ARC. It is only the unfunded portion of that cost that will result in an impact on the financial statements.

I might stop and see if there are any questions at this point.

Chair Kirkpatrick:
That would be great, and as we go along we will stop every couple of pages.

Assemblyman Beers:
On the conversion from the "pay-as-you-go," do you have a projected savings amount? Would that be similar to the savings amount in the other?

Leslie Johnstone:
Toward the end of the presentation, we have comparisons as to what it would cost to pre-fund under different scenarios compared to pay-as-you-go, so I will get into that in a little bit.

Assemblyman Beers:
I have two other questions tied into this. Is the advance funding also a figure near the end of the presentation?

Leslie Johnstone:
The actuaries will need to tell us what the impact of the $25 million is, and so we are working on that currently, but we have got some background information for you to put that into context.

Assemblyman Beers:
And the trust fund? Would this be a static account or interest earning?

Leslie Johnstone:
It would be interest earning. Part of the proposal from our office is to authorize the investing department to have broad authority on those investments, and that has a large impact on the calculation of the Annual Required Contribution. I will get into that in a little bit.

Assemblyman Goicoechea:
Thank you, Madam Chair. I need to clarify a couple of things. You say there will be no liability recorded on the financial statement if the Annual Required Contribution is in place; so then what do we do with that unfunded liability that has been earned?

Leslie Johnstone:
Well, if it is fully pre-funded, then there is no liability recorded. I do not know if that answered your question.

Assemblyman Goicoechea:
What kind of dollars are we looking at if we are going to fully pre-fund it?

Leslie Johnstone:
That will be later in the presentation.

Assemblyman Goicoechea:
Would there then be the capability of non-state jurisdictions also participating in that trust fund to offset some of their liabilities?

Leslie Johnstone:
That is one option, or separate trust funds could be established.

[Slide 9] The OPEB is, in plain English, the health and other benefits that are provided through PEBP. Benefits are one of the State's mechanisms to attract and retain employees. Just to put this in context, this benefit has a very long horizon. Theoretically, if somebody starts in his early twenties he can work 30 years until he is in his fifties, then he can be in retiree status for 30 or 40 years. This can easily go on for 50 to 70 years for a good share of our population in either the single employer or agent multiple employer plans. We are technically an agent multiple employer plan from PEBP's perspective. The requirements are that you project the future benefit payments, discounting those amounts back to today's dollars, and you have to allocate the cost to each of the years of an employee's service. We are looking at past service, so if I worked for the State for six years, I have earned some value to my retiree benefits in fiscal 2007. I am earning the current year's value of my future benefits, and then there are certain odds that I will work future years, and in those future years I will earn more value toward my retiree benefits. You will see us break this down into past, current, and future service years.

[Slide 10] For the State of Nevada, the Public Employees' Benefits Program is governed under Chapter 287 [*Nevada Revised Statutes*] and it establishes PEBP as an internal service fund. That is why we are technically not a plan. We are an internal service fund, as opposed to a trust fund, and Chapter 287 includes provisions for how the retiree benefits will be provided. This is limited to the allocation of the retiree subsidy amount and what eligibility criteria are established. The actual dollar amount of that subsidy is established each session in a Session Bill.

[Slide 11] The GASB 43 and 45, at a minimum, create a lot of work for actuaries around the country. The plan, at a minimum, must do an actuarial valuation of its benefits every two years. For a plan our size, if there are any significant changes either in the benefits or the membership composition, the valuation must be done more frequently. The program had a preliminary actuarial valuation done in April 2005, and it is from that valuation that all of the numbers we will be showing you today are derived. We are in the process of having an updated actuarial valuation completed, but that will not be done until mid to late March. We will have more current information on the demographics available at that time.

[Slide 12] It is a very complicated process to do a fully certified actuarial valuation. There are assumptions that must be taken into account on the demographics: what our retirement rate will be, the withdrawal of the workforce, and mortality rates. Economic assumptions are also critical, and that includes the medical trend, the discount rate, and future increases in the State subsidy. I might emphasize here, that as we are presenting these numbers to you, we are taking them out 30 years, 60 years, so any minor adjustment in these assumptions can have a significant impact on the actual dollar amounts.

What we will be showing you on the different scenarios that we have had done so far, is just for relative impact of each of the benefit scenarios. The dollar amounts themselves are very sensitive to changes in the assumptions that are used. The actuaries have choices for the selection of actuarial funding method and assets model method. There are also assumptions about the plan design, and that is the plan benefit and funding structure that is generally understood by the plan participants. That is what I was referring to earlier. We do not have an employee agreement with our participants, but there are several years of precedent that create a general understanding of what the benefits structure is. The actuaries also determine any implied subsidy, and this comes into play when our costs are commingled between our active employees and our retirees. There is an explicit subsidy that is the retiree subsidy that we all know about and can see on the rate tables, and then because of commingling, there is also a portion of the retiree costs that are spread across the active population. In effect, the active subsidy is paying a portion of the retiree cost, so that is referred to as the implied subsidy.

[Slide 13] At the end of the day, the cost of the program is a function of the benefits that have been perceived to be promised, the demographics of the covered group, and the return on the investments for the assets in the fund.

[Slide 14] Now I will get into some definitions, and you will see a lot of these acronyms on some of the charts that we will be presenting. There is the Present Value of Benefits (PVB), and that is the total projected liability for all current employees and retirees. That is the $1 billion to $4 billion figure that you will hear. It includes the past service cost, the current service cost, and the estimate of the future service cost. It is the one that includes an estimate for the value that I will earn as an employee—the certain actuarial odds that I will work a number of years in the future and during those years earn additional benefits from the State.

[Slide 15] The Unfunded Actuarial Accrued Liability (UAL) is the portion of the benefits that will be paid out in the future, that have already been earned. So in my example, if I have worked for six years, I have earned about 30 percent subsidy under the current structure in the years when I actually retire. The GASB statements provide that capturing this cost can be amortized over a maximum of 30 years. That is a little bit misleading because you would think if we pre-funded, after 30 years that past value would have been fully paid for, but it is really a rolling 30 years. It is "remortgaged", if you will, every year, so it takes a long time for this to diminish.

[Slide 16] Another definition is "Service Cost" and that is the actuarial value of the benefits earned by current employees during the current year. That is the future value of one year's worth of employment. "Future Service Cost" is the cost of all future one-year years of service to be earned, and it is the present value of the cumulative of each of those future years that are estimated that you will work.

[Slide 17] Then we have the Annual Required Contribution (ARC), and I think this is probably the key definition because it is really the driver of what will be recorded on our financial statements. So, we have the ARC, which is the current year service costs, or the value of this year's employment plus a portion of the past year's services that have already been earned. Because these numbers are so large, I think that we by default assume the maximum 30 year amortization period. The ARC does not include any of the future service to be worked.

[Slide 18] To break this down into sections, we have the Unfunded Liability, which is the cost associated with the past years' service, the current year service that creates a cost, and future year service, which creates a cost. The ARC then is approximately 1/30th of that past service figure plus the current year benefit. The estimates done in 2005 brought each year's cost to about 30 years, so the fiscal 2008 figure is $175 million to $273 million. This total bar, depending on the discount rate that is used, is the $1 billion to $4 billion figure. What we are focused on for the financial statements is the ARC at $175 million to $273 million.

Chair Kirkpatrick:
Ms. Johnstone, can we stop for a minute? I think we have some questions, and then we can continue.

Assemblyman Goicoechea:
What concerns me is the fact that we are looking at a figure of $1 billion to $4 billion; that seems like a lot of latitude. When we look at 2008 we see we are going to hit the mark within only 30 to 40 percent, you know $175 million versus $273 million. Are we not going to be able to get a little closer to the estimated need? We are going to contribute a lot of money here if we are going to shore this up. Can we not get within $3 billion of the actual mark?

Leslie Johnstone:
Well, we have got a couple of things going on in this equation, the total liability or the total cost is not what will be used on the financial statement. I do not know if part of your question might be: is it at that range because we do not know what the number is? Okay. That is not the reason there is a range. The lower number assumes that all the liability has been funded so that you are able to assume an investment return rate similar to what Public Employees'

Retirement System (PERS) has, so in all of our models, we are using 8 percent. You do not have to set as much aside if you are earning 8 percent as you do in a pay-as-you-go model, which is the larger number in each of these calculations. In that scenario, all that the statements will allow you to use is your normal treasury interest, which we are using, about 3.5 percent. So you have to set aside a lot more if you are earning only 3.5 percent. It is not that they cannot give us a number, it is just that there are different assumptions on the investment earnings for each of those.

Assemblyman Claborn:
You talked earlier about establishing a contribution trust fund. Would that not come under the Employment Retirement Income Security Act (ERISA) once you have that as a contribution fund?

Leslie Johnstone:
The governmental programs are not subject to ERISA.

Assemblyman Claborn:
None whatsoever? You have no fiduciary responsibility?

Leslie Johnstone:
We do, but not under ERISA.

Assemblyman Beers:
Regarding the actuarial analysis, is there a mechanism in place to essentially change the numbers if and when reality contradicts the assumptions?

Leslie Johnstone:
Hopefully, this will answer the question. At a minimum, the assumptions are updated every two years and more frequently if the plan changes or demographic changes take place. Every time we update it, we are bringing it current to the real world and then making assumptions for the future. Did that answer your question?

Assemblyman Beers:
Yes, and the other question was, if someone ties into what Mr. Goicoechea was talking about, these assumptions are based on two conflicting models, is that correct?

Leslie Johnstone:
Yes, they are conflicting because one says we pre-fund and the other says that we do not.

Assemblyman Beers:
It honestly looks like saving money is a plus—why do we have the conflicting models if we have one that appears to be more effective?

Leslie Johnstone:
I think it is just that everything at this stage is informational for the Legislature and the Governor. We need to provide the information, what the impact is if we continue on a pay-as-you-go versus if we pre-fund. As administrators, we have an obligation to tell you, "if nothing changes here is what the cost is versus if you fully pre-fund, here is what the cost is."

Jon M. Hager, Chief Financial Officer, State of Nevada, Public Employees' Benefits Program:
These numbers do not take into account the current $25 million pre-funded annually for the Governor's recommended budget. There is an amount that the actuaries are actually looking at right now. It is going to fall somewhere between these two numbers. If we were to pre-fund $25 million a year and increase that with inflation or some assumption, the total liability would be somewhere between $1.6 billion and the $4.1 billion.

Additionally, the ARC, which you see on the bottom of the page, where we say it is $175 million to $273 million, that ARC would also be somewhere between $175 million and $273 million. Now, we do not know what that is because using that $25 million figure, you are using a blended rate between 3.5 percent where you did not fund anything, and 8 percent where you fully funded it. We need to find out from the actuaries where that blended rate is going to be, and we will be able to get that in, like Leslie [Johnstone] said, late March. We will be able to get the actual figure, and later we will talk about what we actually put on the books.

Chair Kirkpatrick:
What percentage are you figuring into this for each year's benefits increase when you are looking 30 years out?

Leslie Johnstone:
In the calculations that were done in 2005 and the ones that are being updated now, they assume the current plan design at the time, so it assumes no plan design changes and they will apply their trend estimates, which for us is about 11 percent. One of the key items on that point is in the assumptions about the medical trend. It is assumed that the trend will decline in future years. The growth of medical costs, at 11 or 12 percent in our case, will overtake the finances of the State budget. On a global scale, economists say something has got to happen with the medical system to lower the costs down to something in

the neighborhood of the Consumer Price Index or slightly higher than that. An important assumption regarding the medical trend is that as near term as ten years from now, the assumptions have us not at 11 percent but in the neighborhood of 5 to 6 percent. It is a major assumption that those types of changes will be made in this plan design, and/or the medical industry will actually have that lower cost increase.

Chair Kirkpatrick:
So, if this session, we were able to put a formula in place, do you perceive that the formula would be able to work for a good eight to ten years, or would we have to revisit it? Or is this something we are going to have to do every session? Will we have to reevaluate for the next ten years until we can get our costs under control?

Leslie Johnstone:
I would like to think the former; it is probably the latter. These are some pretty significant assumptions that are being made. Even if there are some plan design changes, we will have to reevaluate the medical industry every two years at a minimum. I do not know how the actuaries would answer that question, but I would venture a guess that we will need to revisit this on an ongoing basis.

Jon Hager:
Madam Chair, if I may. If the assumptions turn out to be correct, and the actuaries are using this medical inflation, and everything else turns out to actually match what happens, then the Legislature should not have to do anything else. As PEBP, we will still have to do the actuarial valuation every two years. That is not to say that the State may decide to change benefits in the future, in which case there will be a change in pre-funding. Assuming everything stays the same and the assumptions are actually met, then the Legislature should not have to do anything additional.

Assemblyman Stewart:
In terms that I can understand, on a scale from one to ten, how concerned are you with the solvency of this program? With one being no concern and ten being extremely concerned. I would like you both to give me a number.

Leslie Johnstone:
With the caveat that the funding policy of the State does not change, I would put very little concern on the program solvency. We are on four years of very healthy financial statements, and the infrastructure of the program is such that we could carry on. That assumes that the State has the wherewithal and the willingness to continue the subsidy at the current percentage of the overall cost.

If we got into a position of having to shift the cost even more to the participants, then I would have a different answer.

Assemblyman Stewart:
So about a four or five?

Leslie Johnstone:
Sure.

Jon Hager:
Exactly what she said. The current financial status of PEBP is sound, and as long as claims costs do not skyrocket for some reason, we should be financially sound for the short and intermediate future. What this is doing for us is looking at the long-term future; you are looking 15, 20 years down the road. I know it is hard to think of that when some of these things go 60 or 70 years out; we are not going to be around then, but toward the end of the presentation you will see how enormous these costs are. It is the prudent thing to deal with it at this time.

Assemblyman Stewart:
You will still be around but I will not.

Leslie Johnstone:
[Slide 19] So, considerations for the Legislature fundamentally are whether or not to pre-fund and to what degree to pre-fund. The method of calculating the GASB expense goes toward the assumptions that the actuaries will help us advise on. The amortization period is a maximum of 30 years, but it can be as low as 10 years, so there are choices there. Necessary legislation might be required if it was decided to amend the plan in order to address some of the State's liability, and then on how to deal with the implicit subsidy or not deal with the implicit subsidy that results from the commingling.

[Slide 20] To the question of whether to pre-fund or not, as I said, GASB does not require any pre-funding and the choice is entirely left up to the entity, and that decision can change from year to year as well. The impact of pre-funding is what I was trying to describe earlier on the discount rate that is acceptable for the actuaries to use. If the State does not pre-fund any of the liability, then the discount factor is in the neighborhood of 3.5 percent, and if the State does decide to fully pre-fund, then it is in the neighborhood of 8 percent or similar to what PERS is able to use. Regarding the impact of the pre-funding amount included in the Governor's recommended budget will result in the actuaries recommending a discount value somewhere between 3.5 percent and 8 percent.

Because of the dollar amount involved here, it will be closer to the lower end of the range.

The last point is that pre-funding has a large impact on the liabilities recorded on the statewide financial system to the degree that you can have two plans that are exactly alike except that one pre-funds and the other one does not. One jurisdiction will have an ARC liability and the other one will not. That is one of the factors that we are interested in. For instance, there is a lot of talk about how the bond rating agencies will view the liability on the financial statements, and that is yet to be determined because the GASB requirement is relatively new for all of the governmental entities. It is yet to be determined exactly what the response will be from rating agencies.

[Slide 21] In selecting the funding method, there are a lot of accepted methodologies that the actuaries can apply when calculating the liability. The methods differ on how they allocate the benefits over time. The bottom line is the long-term cost is the same under each of these, but some have more conservative funding requirements early on, and some delay the funding requirements farther into the future.

[Slide 22] So far, each time that we have gone through the actuarial valuation process we have used the same demographic assumptions as the PERS does as an acceptable method. The demographic assumptions that have the most impact are age at retirement for our program, rates of termination where there are no benefits paid, and the rates of mortality.

[Slide 23] Most of the economic assumptions are unique to this OPEB valuation, and those with the most impact have to do with claim increases and the premium rates themselves, medical inflation costs, and the rate of increase from the retiree contribution. In other words, the employer's share continues to be a certain percentage included in the assumption, and therefore, the retiree is paying the same share of the cost. The discount rate is impacted mostly by whether it is pre-funded or not, and then the salary scale is part of the calculation as well, even though it does not have a direct impact on our benefit cost. We use the same salary scale that PERS does in its valuations.

[Slide 24] The impact of any plan amendments, it should go without saying, is that the State's liability would be decreased if the State's obligation to the retirees was decreased. This could happen in a variety of ways or combination of ways: it could be a straight-out reduction in the State's contribution without any benefit changes, so it would just be a cost shift to the participant; it could happen by lowering the current benefits and keeping the State's contribution about the same; or it could happen through programmatic changes that have a long-term impact such as the wellness program that PEBP is pursuing. If that program was able to impact the overall health status of the employees as well as the retirees to a significant degree, it could influence the trend that the actuaries use when they are calculating this liability. That would take several years to have any credible evidence for the actuaries to use. The extreme would be to cut retiree benefits to new hires as another way of lowering the liability. We will show later in the presentation about eight different scenarios that we have asked the actuaries to develop so far, and we will have a discussion on the relative impact of each of those scenarios.

[Slide 25] This next slide shows the impact of commingling, whether or not there is an implicit subsidy. The reason we emphasize this is budgetary, the amount of the pay-as-you-go. We cannot simply look at that retired employee group insurance account and say that is how much we have put toward the ARC. We have to estimate out of the active employee subsidy how much is going toward the pay-as-you-go value as well. In the situations where we have the first row, where the actives commingle with Medicare and non-Medicare retirees, there is an implicit subsidy that occurs. If the actives are just commingled with the non-Medicare retirees, there is still an implicit subsidy. The only way that we have no implicit subsidy is if the retirees are rated on their own, and therefore the subsidy is calculated separately and apart from the active employees.

Chair Kirkpatrick:
Ms. Johnstone, we all have questions.

Assemblyman Goicoechea:
I am looking at the hidden liability on commingling Medicare and non-Medicare retirees. Clearly the difference there would be in the premium. That is why there would not be any subsidy. Then I would like to go back to the commingling of all groups. A pool helps spread exposure. Realizing there might be a liability or a subsidy, it is advantageous to try to maintain a stable rate for everyone. Could you clarify that for me?

Leslie Johnstone:
You are exactly right. I bring up the issue about commingling not to talk about the pros and cons of it, but simply to let the Committee know that when we commingle, we have to look at our pay-as-you-go amount a little bit differently. We have to get it from the retired employee group insurance account as well as estimate it from the active subsidy. I am trying to clarify that it changes how we look at and how we will calculate the unfunded portion of the ARC.

Assemblyman Goicoechea:
Going back a few pages, I was thinking about some of the non-state groups that may not have a lot of exposure at this point. It seems that it would make sense for them to move ahead and try to pre-fund and set up a trust account. I assume they could probably do that to avoid some of the GASB regulations. With Assembly Bill No. 286 of the 72nd Session, we brought a lot of people into this and ended up paying a subsidy that maybe we did not even intend, but at this point they would have a very small liability under GASB, and maybe it would make sense for them to pre-fund that if they could.

Leslie Johnstone:
Certainly it will depend upon each jurisdiction's demographics and their financial wherewithal to pre-fund. Unfortunately, the way this calculation is done I bet it is not a small amount for any jurisdiction. It is an option out there that everyone has available.

Assemblyman Goicoechea:
There are some jurisdictions that have very few employees and they might have only two or three that are actually retired. Clearly, they are in the same position. They do not want to move ahead and say there will be no benefits for new hires; it makes it difficult to recruit. Maybe they are better off, if we are talking 8 percent returns on a trust fund, setting that up and looking to the future.

Leslie Johnstone:
Now that 8 percent will vary depending on the size and whether the local jurisdictions created their own trust fund or we had a statewide trust fund: the bigger the fund, the more credibility there will be using an 8 percent return. If you have a small population that you are accounting for in your trust fund, the money is just not going to be there to get that kind of return.

Assemblyman Goicoechea:
That is why I wondered whether the State is going to make this trust fund available to state and non-state jurisdictions, because clearly that combination would bring a higher rate.

Leslie Johnstone:
That is a policy consideration; I would venture a guess that you will see bills out there for local trust funds and also the one we have drafted for the State's purposes.

Assemblywoman Parnell:
A question about the term "pre-funded." I think it might help all of us, especially when we say "dependent on whether or not the plan is pre-funded": what are the scenarios for who are doing the pre-funding? I think that is hard to see. If you could identify different ways that the plan could become pre-funded, I would appreciate that information.

Leslie Johnstone:
I will attempt to answer that. I think the simple thing is when we talk about pre-funding; we are talking about the employer's responsibility. The pre-funding, if I go back to the chart on slide 18, the ARC, if the amount is pre-funded for fiscal 2008 and this was done in 2005, it was estimated at $175 million. Now the State, through its retired employee group insurance and the implied subsidy on the pay-as-you-go method, is setting aside about $40 million. So, the amount that would be recorded on the financial statements is the difference between $175 million and the $40 million. If we leave out the part about the discount for now, it is the difference between the ARC and the amount that is included in the pay-as-you-go. The employers setting aside money is just that, instead of budgeting $40 million, they would need to budget $175 million in fiscal 2008 to be considered fully pre-funded for that year. The scary thing is that this is not a one-time deal. We have these kinds of figures for each year in the plan, and each year will stand on its own whether or not it is pre-funded. What goes on the financial statements is the cumulative amount that has not been funded.

Assemblywoman Parnell:
Let me do a quick follow-up. So, according to the paperwork, when you use the term "pre-funded" you are really just looking at, in a sense, the State coming in every two years, pre-funding or assisting that pot. We are not talking about different groups that could start pre-funding for their retiree care or anything out of the box. The State would simply come in and pre-fund to offset the long-term liability.

Leslie Johnstone:
Right, this is separate and apart from various mechanisms that might be there for the employee and retiree to save toward their portion of the cost. This liability is just the employer's share.

Jon Hager:
It is also important to understand that this $1.6 billion to $4.1 billion liability is the State's share of it. So out of the 29,000 state employees and retirees, that is the State's share: it does not include the non-state portions, and it does not include the employee's portion either.

Assemblyman Claborn:
I think earlier you stated that this program would be fully funded?

Leslie Johnstone:
Not without any policy change. We are on a pay-as-you-go method currently.

Assemblyman Claborn:
I sat on the trust fund with the Operating Engineers for 24 years as a fiduciary, and I am having a hard time understanding this program. The President just pushed a bill through Congress last year that stated if your pension fund was not fully funded, then participants would not receive any benefits until it was fully funded. In the meantime, if you were 14 percent funded toward your actuary, then you could receive benefits. We have never been fully funded, and we have been in existence since 1960. It really creates a problem that I am having a hard time understanding. I am going to try to listen a little bit more, and maybe later I could get a one-on-one with you.

Leslie Johnstone:
Certainly, one point of clarification, the ability to receive the benefits refers to non-pension benefits and therefore has not been constrained. The idea of having any kind of pension guarantee is not "out there." What the GASB 43 and 45 statements started to address is simply recording what the cost of the health care retiree liability is.

Assemblyman Claborn:
We are a long way from meeting our actuary and this has created a real problem with our members because of the simple fact that they do not want to put any more money into the fund if they will not receive any more benefits. We just started our 30-year actuary, and we are a long way from being fully funded. It puts a kink on our pension fund.

Leslie Johnstone:
The non-pension funds will be a little bit different because the participants are not being asked to put in anything other than their share of the contribution for the current year. There is nothing requiring the participant to pay toward his retiree health benefits.

Assemblyman Claborn:
Of course, the only way to make it fully funded is to put more money into the fund. That is a hindrance on our membership; it is a real problem.

Assemblyman Goicoechea:
I have sat on the A.C.R. 10 Committee [Legislative Commission's Committee to Study the Public Employee's Benefits Program] for the last two interims and I really appreciate the information you are bringing forward. I think it is more than we have seen in the past. Just a thought, one of the options is, and it was proposed by Governor Guinn last session, was closing the plan to new hires. I think that maybe there is the ability to start at some point in the near future to require new hires to come onboard with an employee contribution. To help offset and pre-fund, we have talked about this in the past: maybe taking a small percentage, very similar to what we do for PERS, nothing like the 18 percent, but maybe 1 or 1.5 percent and commit that and cut the exposure off at that point, and come up with a long-term retirement program for health care benefits. Any thoughts on that?

Leslie Johnstone:
Just a mechanical approach to that consideration, using salary and setting that aside to go toward the liability, would reduce the State's liability if that salary amount was recorded as the State's share. Instead of withholding some of the salary, it is almost more direct to say that you will forego the amount. The State, instead of appropriating that money for salaries, would put it toward this trust fund. It needs to go to the employer's cost to have an impact on the State's liability so setting aside some current salary to pay the retiree's share of the cost in the future will not impact the State's liability, unless there is also a plan change that would say in the future, the retiree is going to be responsible for a higher percentage of the cost than they are currently.

Assemblyman Goicoechea:
I was only looking for a mechanism to at least make some contributions to a trust fund, as an example, that would offset down the road, and I think it clearly would be more palatable than just saying "any new hires are not eligible." I really am apprehensive about down the road, especially the non-state's side when they may say look at GASB and the liability, and cut off new hires.

Leslie Johnstone:
There are some very tough policy decisions that have to be considered because, the way these calculations are done, you have to make rather significant plan changes to have a large impact on the liability, even in the example of cutting off the new hires. It takes many years for that to show up as a savings. We will be able to show that in some of these later slides. Some of the impacts take effect almost immediately; others take many years to show any reduction in the liability.

Assemblyman Goicoechea:
I agree, as Mr. Stewart said, some of us will not be here to see the end of this liability. Thank you.

Chair Kirkpatrick:
I have a couple of questions. How many employees do we have on the retiree list between the ages of 50 and 60?

Leslie Johnstone:
I do not have a sense for that number, so I would not be able to estimate it. We can get it to the Committee.

Chair Kirkpatrick:
I want to follow up with this: A percentage of the ones between 50 and 60, how many of them are currently working in another part of the government? They have retired from one portion and are collecting benefits, and they now work for a different part.

Leslie Johnstone:
There are limitations on that dual status, and for us, the definition of a "retiree" requires you drawing from PERS. If you are not drawing from PERS then you would have to be considered an active. What I can get is the count by age of our active population and our retired population and from where they retired.

Chair Kirkpatrick:
Where do we compare with other states? I know we are not the only one going through this process right now. Has there been other legislation implemented that we can see or are we all doing it at the same time?

Leslie Johnstone:
I think that we are all in it together. Our actuaries will say that even the Governor's recommendation to pre-fund the $25 million has been leading edge compared to what other states are pursuing. They are all tending to be in their legislative sessions now, probably having this discussion in many rooms across the country. Other than some plans that operate their health benefits through their retirement systems, as in some reports I have seen that they are using a portion of the retirement contribution to go toward their retiree costs, I am not sure that there are any states that have taken large strides towards pre-funding yet. But as I say, we are all having the discussions at the same time.

[Slide 26] The next slide has to do with the Annual Required Contribution for the next biennium and trying to represent the impact of the Governor's $25 million pre-funding. We need to get an updated estimate from the actuary, for exactly what the impact of the Governor's recommendation is. So starting at the top, if I focus on fiscal 2008, the fully funded Annual Required Contribution would be $157 million, which goes up to $273 million if we stay on the pay-as-you-go basis. Moving to the bottom, we have the direct subsidy for the retired employee group insurance account budgeted at $36.5 million. We have an approximate $4 million implied subsidy, so under pay-as-you-go, we have approximately $40 million toward the Annual Required Contribution. Then in the fully funded scenario, it would require another $116 million to total $157 million; with the pay-as-you-go method we would have only the $40 million, and so we would have a reported liability of the difference between $40 million and $273 million, which is $232 million. The middle bar shows that we have $40 million set aside through the subsidy, $25 million pre-funded, and we will have to re-estimate what the ARC is under that scenario. It will be somewhere between $157 million and $273 million, and the difference then is what will be reported as a liability. The dollar amount of the pre-funding will be closer to the pay-as-you-go column. Any questions on the Governor's recommendation?

Assemblyman Goicoechea:
I just want to make sure I understand the graph. If we put the $25 million in, our exposure will still be someplace between $190 million to $200 million roughly; it would still be a large number? So even $50 million is a very small Band-Aid?

Leslie Johnstone:
Yes, the liability would still be a large number.

[Slide 27] The next section provides the Committee information on the scenarios that we have had the actuaries work on using the 2005 demographic information. So these are provided to give you the relative impact of each of the scenarios. Please remember that the amounts we will show you will be updated with our new actuarial valuation if we have them redo these scenarios. They are simply being shown to give you a directional impact.

Considering the benefit changes that we are talking about, I would also emphasize that PEBP sees its role as providing information to policymakers. We are not making any recommendations on these scenarios; this is from a staff perspective of what we thought might be the most commonly asked "what if" scenarios from the Legislature and the Governor's Office. Some of the scenarios will have varying impact on recruitment and retention of employees and rate of retirement, that kind of thing. The medical inflation exceeding the CPI (Consumer Price Index) for an unknown period of time, which I talked about

earlier, and the assumption behind these numbers is that in about ten years we start to see a significant decline in the medical trend cost.
[Slide 28] I will go through these scenarios slowly and then we will show some graphs that hopefully depict what the impact is in general terms. What we will refer to as the base scenario is the current benefit structure and the current subsidy structure, so that does not even include the $25 million in pre-funding. These scenarios were done prior to the Governor's recommendation, and so we do not have that scenario included here.

The first scenario was to eliminate the subsidy for new entrants starting July 1, 2008, so this is very similar to the previous Governor's proposal in the 2005 Session. The second scenario would be to decrease the subsidy by half starting July 1, 2008, and then allow it to grow again at medical inflation. The third scenario would freeze the subsidy, so in this situation all the cost increases would be passed onto the participant. The fourth scenario would be to eliminate the subsidy for people retiring after 2012, five years from now; the idea was there might be some time for retirees to start to accumulate some funds to offset the costs that they would face in the future. The fifth scenario was done during the 2006 interim. It was to decrease the benefits and change the plan design so our growth would be something similar to the CPI. We did not update this because the actuaries will say they cannot attest to this kind of valuation. It is not practical without changes in the industry that you would be able to reduce the growth; you would decimate your plan in short order. The sixth and seventh scenarios have to do with how the commingling occurred. We repeated only the one in which we would have retirees separate from actives, so under this scenario we would not have an implied subsidy. I will talk about the impact of each of these as we go. Scenario seven would have separated Medicare retirees from actives and non-Medicare retirees; we did not update this because it caused a cost increase. We did not think there would be much discussion about that option. Scenario eight would eliminate the subsidy for retirees as they become eligible for Medicare. Scenario nine would be to eliminate the subsidy for retirees with less than 20 years. I tried to describe the subsidy schedule yesterday in which retirees are eligible for some subsidies starting at five years of service. With our average retiree having a subsidy equal to about 17 years, this scenario focused on that subsidy as a reward for longevity. It would not start the subsidy unless you had 20 years of service. The last scenario would eliminate the subsidy for dependents; the plan allocates a fair portion of the subsidy to offset the cost of dependents, so scenario ten would focus on just the retired employees themselves.

Chair Kirkpatrick:
Mrs. Johnstone, could we ask a few questions?

Assemblyman Beers:
I would like to request one more scenario. Mr. Goicoechea brought it up and it is not listed in any of these. I refer to the one with the employee salary contribution. I realize that the mechanics might be a little difficult, but it appears to me to be more workable than a lot of these that I see.

Chair Kirkpatrick:
Mr. Beers, could you state exactly what you want from her, and give us a time frame so that the rest of the Committee knows and I know that it is a big timely process to do that.

Assemblyman Beers:
Well, as Mr. Goicoechea said, not a large percentage, but a small percentage of the salary would be allocated to a contribution to the program.

Leslie Johnstone:
We can put together an analysis for the Committee. The result is that the calculation of the Annual Required Contribution does not change. It is just how much goes toward pre-funding in that scenario, if I am following that correctly.

Assemblyman Beers:
Yes, and this would be new hires.

Leslie Johnstone:
We can put together an analysis on that.

Jon Hager:
These scenarios are only for benefit structure changes; they are not for actual funding. The mechanisms for funding will be slightly separate from this. So currently the actuaries are looking at the $25 million funding that the Governor recommended. We can decide what scenarios to present to them and then also decide how much funding to provide for that. So this is a scenario that we could look at, but these scenarios in particular are looking at structure changes, not funding differences.

Assemblyman Beers:
Thank you for the correction.

Assemblyman Atkinson:
I think that Mr. Beers said it at the end, new hires. How much would that impact? There are not a lot of people coming into the system at a fast pace.

Leslie Johnstone:
Frankly, I did not catch that part of the request. Only new hires would set aside a portion of their salary. Without being an actuary, I think I can safely say that would take a long time to have an impact.

Jon Hager:
The current funding, the $25 million, was structured out of REGI (Retired Employee Group Insurance). Currently to get the money for REGI, we assess a percentage of payroll to each agency. The $25 million increased that percentage of payroll by about 1.6 percent in 2009 and I think it was a little bit higher in 2008. If you look at 1.6 percent of the entire payroll population, you get $25 million. If you are looking at just new hires, this would not have much effect on the overall system. To fully fund it you are probably looking at 8 to 10 percent of payroll, but do not quote me on that.

Assemblyman Goicoechea:
I think that we are getting a little off base here with what I was talking about. We are talking about new hires and we are talking about exposure 30 to 40 years down the road and how we are going to meet that. I like it a lot better than eliminating the subsidy or decreasing the subsidy or making any plan changes. I think that as you have new hires come on board, I would like to see them have the ability to opt-in and pre-fund their retirement health care when they are hired, rather than the Legislature down the road, being faced with having to make some of these hard line decisions, saying for example, no health care benefits upon retirement. I think that is part of the package that we need to look at. I do not think that we are talking about anything that would be immediate or even in the near long term. We are saying, if you were hired on or after July 1, then you would have the opportunity to select that coverage. You could take the money and decide that you are never going to need retirement health care benefits or determine that you would like to pre-fund your retirement health care package. If you would take a 5 percent reduction in your salary, you would allow the state or the local non-state government entity to use that money creating the trust fund and pre-fund your retirement health care. I think it is just an option we need to look at for new employees because clearly what $50 million does to the total liability scares me to death, and I know in the end we are going hear that number that none of us wants to hear.

Assemblywoman Parnell:
I could not agree more with my colleague from the rural areas. I think what gets confusing is, as I look at this in a big picture, we are being asked—the State is being asked—to do something to offset the long-term unfunded liability. If you look way out into the future, we need to show that we have put something in place that will begin to shift that liability. I could not agree more

with Mr. Goicoechea's and Mr. Beers's comments because if we start assessing a new hire with even a small amount, it goes into a pot that just grows and grows in a trust fund, so that down the road you have new hires offsetting that long-term liability. I think some of us see it like that.

Assemblyman Goicoechea:
It would offset their liability that they would accrue over the long term when they reach retirement age.

Leslie Johnstone:
Madam Chair, to help us get this information back to you: is the assumption that if new hires set aside some of their salary that in the future they would receive less of an employer subsidy?

Assemblyman Goicoechea:
What I envision, and I am not sure that I have the mechanics down, is that in 2012, give or take a year, we give new hires the option of either participating in the plan and offering a contribution that would be there to offset the long-term health care liability; or, that new hire could say "No, I do not want to participate in the plan" and take more money. At that point, when he enters into the program—it would not be just like cutting off and saying "New hires will not be eligible." He would have the option, either to be eligible for retirement health care benefits out of that jurisdiction, either State or non-state or, if he chooses to participate in the program, he assumes then that he would be there for the long haul, would retire from that jurisdiction, and would have health care benefits available to him. If he opted not to, they would not be available to him. I am looking at this 30 years down the road. We have got to do something to stop the hemorrhaging.

Chair Kirkpatrick:
We need to wrap this up so that we can continue forward. We can get our ideas together as a Committee; I think you know where we are headed. I believe from what I have heard, the consensus here is we would like to see you come back with something that says if a new employee starts, he knows from the get-go that he will have to pay between 1 percent and whatever number that you foresee could make a difference. The new hire would start with a percentage that could opt into the retirement benefit system, or he could choose to opt-out. For example he would see that his job pays $12 an hour and know that if he contributed $1.10 an hour, he would be part of the benefits system or could have more in his check and not be part of the system. I think that is the consensus that we are trying to get out of this. As you bring that forward, we can then dissect it because this is truly just an overview.

Assemblywoman Parnell:
We recognize that down the road, because of the enormous cost of health care, this is going to become a shared responsibility. The State will have a share and future employees will have a share of that responsibility. So that pot would not be made up of State money or employee money, but rather it would be a pot that grew because of shared contributions.

Assemblyman Beers:
I would like to see the numbers carried out to, say, the year 2053 to see what effect that has on the contribution percentages paid by the State and by the employee. I would estimate that after that period of time, with continual growth and wise investment, those shares might equal out. That is just my assumption.

Chair Kirkpatrick:
Mr. Beers, can we simplify it a little bit and just start with this, and then we can look to the future. You want her to project 30 years into the future to see what the savings would be if the employees are part of it, is that correct? [To Ms. Johnstone] Does that not take time to do something, so could we have two different scenarios as opposed to waiting for all of it?

Leslie Johnstone:
We might be able to provide some information on the concept to the Committee in the next couple of weeks. Then I would ask that the Committee consider that information and whether or not you would still want the actuarial estimation to be done. We want to provide all the information you need to make your decisions. The limitations we are facing are that it is going to take about five to six weeks for the actuary to update the valuation, that is bringing us to about mid-March, and then it takes about two weeks for each scenario that is developed. I am told that there are no economies of scale on doing these scenarios. We do not have unlimited resources on the actuarial side to run a lot of different scenarios, much less your Committee's time. To help address some of the questions, I think we can do the analysis on the approach in the next couple of weeks, and then if the Committee still wants us to have the actuary run the scenario, we will not have lost any time because right now they are working on updating the actuarial valuation.

Chair Kirkpatrick:
I am just seeing flashbacks from last session where everybody was going in 900 different directions, and a different part of the system was unable to get anywhere because everyone had his own ideas. I would like us to stay with the first part of that, and then we will proceed in the future.

Assemblyman Settelmeyer:
I think that we all agree on putting a tourniquet on it, per se, in order to cut the bleeding, but we owe something to our employees in the future as we owe the employees who are in the system now. In talking about a percentage of contribution from new hires, what percentage would have them fund 25 or 50 percent of the total cost of the program? Do you have any idea what that would be? Mr. Goicoechea and Ms. Parnell are talking about 1 or 2 percent; is that 5 percent of the cost or 50 percent of the cost?

Leslie Johnstone:
I should not venture a guess at that here, and I think that is part of what we can look at to give you a ballpark estimate in our internal analysis.

Assemblyman Settelmeyer:
If the employee kicks in 1 percent, how much of the total cost would they be helping to offset?

Chair Kirkpatrick:
The reason I said 1 percent is that then we could calculate ourselves how the bigger portion would help, and how it would change throughout the years. I personally am not a big fan of opting out altogether because then we would wind up moving our resources to indigent care. I am willing to have the discussion; that is the direction the Committee wants to go, but personally I do not agree with it.

I have a question on scenario ten. Do dependents include spouses and grandchildren raised by grandparents? And is it an option to opt in or to opt out of that? Would that change the scenario?

Leslie Johnstone:
Could you restate that question?

Chair Kirkpatrick:
When you talk about eliminating the subsidy for the dependents, does "dependent" mean spouse, children, or grandchildren?

Leslie Johnstone:
Yes.

Chair Kirkpatrick:
Would it be considered a plan change if that was an option? For instance, many grandparents are caring for their grandchildren, so would that be something they

could opt into so they could have the coverage if they were put in that situation? Would it change our liability by making it a flexible part of the plan?

Leslie Johnstone:
I do not think that has an impact because they have the option, each open enrollment period, which dependents they would cover by the plan.

Chair Kirkpatrick:
If we are talking about eliminating it, what difference does it make if they have the option?

Leslie Johnstone:
The dependents could still be covered, it just means that the participant would pay the full cost of those dependents instead of some of the cost being paid through the subsidy.

The table on Slide 30 takes us out to the year 2038. It shows for each of the scenarios—by net State benefit cost, which is the current year, pay-as-you-go-cost—what the cost will be in 2038. The scenarios are listed and ranked as the pay-as-you-go cost, so the base amount would be $608 million in 2038. The next most expensive scenario would be where the retirees are separately rated from the actives, scenario six and so on.

The middle column is what the Annual Required Contribution would be in 2038 if it is fully pre-funded. If the State wanted to maintain the current benefits and wanted to be fully funded, for that year it would have to contribute $955 million. The third column compares the base program under pay-as-you-go current benefits to each of the respective scenarios if they are pre-funded, so the idea of this information is: if we make no changes, we keep the current benefits and we keep going as pay-as-you-go; compare that to a scenario in which there is a plan change and the plan is fully pre-funded. The comparison then is when we break even between status quo and plan changes that are also pre-funded.

For example, scenario six on commingling, it would take until the year 2050 for it to be lower in cost to change the benefit and pre-fund than it would be to continue as pay-as-you-go with our current benefits. In scenario ten, which eliminates the subsidy cost for dependents, it would take until the year 2045 to have it be lower cost under that scenario, fully pre-funded, than our current pay-as-you-go. By eliminating the subsidy for those who have less than 20 years of service, scenario 9 has a break-even point at 2038; eliminating the subsidy by 50 percent, scenario 2, has a break-even point at 2032. These are all approximate and could change with our new valuation that is being done. In order of magnitude this should be helpful information. The scenario of eliminating the subsidy for new hires takes until the year 2024 to show a cost savings. It is probably important to point out that the assumption here is that for each of the years under the scenario, the Annual Required Contribution is fully pre-funded. It is not just putting the dollar amount aside that is showing in this middle column, it is the significant amount pre-funded each year and the commitment to do that.

Scenario eight eliminates the subsidy for the Medicare retirees, and that has the quickest payback or cost savings. In the year 2038, the estimated cost under pay-as-you-go would be $202 million. The pre-funded amount would be $314 million, so it would have an offset in 2015. The subsidy being eliminated for retirees after 2012 offsets at the year 2021, and freezing the subsidy offsets at 2009.

[Slide 31] The next chart shows the same information but in a graph form. The top line is the base benefit and subsidy structure, so it is the highest cost each year. Then each of the scenarios is shown, the projected pre-funded amount for each year. These amounts would have to be pre-funded each year in order for those breakevens to show. I am getting ahead of myself. This chart shows the pay-as-you-go-amount for each scenario.

[Slide 32] In the next chart the dollar amounts are different but in nearly the same order. It shows the pre-funded Annual Required Contribution amount. Let me skip ahead to the one with the offset that shows the pay-as-you-go amount against the pre-funded Annual Required Contribution for each scenario. You can see that on some of these scenarios, as in scenario two, which has the squares as the markers, there are some short-term reductions and then it goes up at a certain slope. Scenario nine, which eliminates the subsidy for those with fewer than 20 years, that is the open square, has a reduction of cost around the year 2013, and then it starts to go back up. The reason for that is the assumption that employees would start to work longer if they were subject to losing their retiree benefits if they had fewer than 20 years. At some point the costs go back up. The dark line with the large circles shows the break-even point for each of the scenarios and has the same information that was on the table that I showed with each specific year.

The next chart shows the same information but is taken out to the year 2068. Probably the most significant point on this chart is that you can see how the projection for the current benefit structure grows so much faster than each of the other scenarios that we have looked at so far.

Jon Hager:
To compare this, the orange triangles, the top group of lines, is the base case fully funded, so if we use today's benefits structure and we completely funded the liability, that is the orange; and you can see prior to about 2053 it costs a lot more than the pay-as-you-go portion. But when you pull out to about 2068, you can see that the actual annual cost of retirees is upwards to about $6.5 billion, just for the year 2068. If we were to put a large amount of money in these prior years, we could use the interest earned on those investments to cover the difference between the amount we have to pay in that year and the net State benefit costs for retirees that year. The savings in those years is a little over $2 billion if we were to fully fund over the entire time. Again, this does not change the program in any way, it is the current benefits structure, and we fully fund it. The other options that you see in the different colors and different markers are if we change the benefit structure and fully fund it. What we are trying to show you, if we were to continue doing what we are doing today, are the years that we would start making money by changing the benefits and fully pre-funding. That is what the table on the previous page before the charts shows you.

Chair Kirkpatrick:
We have a whole new set of questions. I want to thank the Committee for participating and asking questions.

Assemblyman Christensen:
For that 2068 figure fully funded, to hit those numbers, to have that kind of spread, what are the return assumptions?

Jon Hager:
For the fully funded returns, we are 8 percent. We assume what PERS is getting now on their investments.

Assemblyman Christensen:
What have been their return averages over the last 15 or 20 years? Do you know that figure, the long-range State returns on investments?

Leslie Johnstone:
I just watched the PERS presentation a couple of weeks ago. It seems like in the long term it exceeded the 8 percent slightly, but they were staying with 8 percent for their actuarial valuations.

Assemblyman Goicoechea:
As I look at what we are proposing, clearly only one and three would really fit in the scenario because otherwise we would be penalizing people we have already

got in place and who anticipate that these programs are coming forward. Maybe you talk about eliminating the subsidy for new hires when an employee comes on board and knows that he is not going to receive a subsidy, that is one thing. Even if the subsidy is frozen, most people anticipate they will have a subsidy even though the exposure would grow. As I look at what is being proposed here, those are the only two scenarios that would work, unless we can come up with a variation from a policy standpoint. We have employees who have been with the system 30 to 40 years and are anticipating they are going to have something, and then we turn around and say we are going to eliminate the subsidy for your dependents. Those are major hits when you are 60 years old.

Assemblywoman Parnell:
Regarding new hires and doing a pre-fund, if you were to look at the chart and the baseline, that is the highest—if you start, say in 2008, with new hires paying into that retiree care, is that not going to dramatically bring that line down? Is not that high number going to be reduced because of the employee contribution?

Leslie Johnstone:
It will be a function of what that percentage is and whether or not that funding is earmarked for the employee's share or to offset the employer's share of the liability. All we are focused on here is the employer cost, so in the scenario where there is pre-funding from the employee, part of what we will get back to you is the impact or an estimate of the impact. If the employee retains access to that money, as he does with his contribution to retirement, he always has the ability to pull that out, so unless there is employer reduction in the employer's share, it does not impact the employer cost.

Assemblyman Settelmeyer:
You keep stating employer/employee cost, what percentage of the cost are the employees currently paying?

Leslie Johnstone:
Overall, the retirees pay approximately 41 percent of the cost and the State pays approximately 59 percent.

Chair Kirkpatrick:
Thank you very much for coming, and I am sure that we will be contacting you again to come back. We do have some public comment. The public comment is just to speak on the overview. We have no bills, and this is not a hearing. We will be taking the public comment as advice.

Terry L. Hickman, Executive Director, Nevada State Education Association:
Scenario eight talks about eliminating the subsidy for Medicare recipients. Currently, if you were hired as a teacher or support professional prior to 1986, you do not pay into Medicare. The only retirement you will have is either through your own district or through the State plan. We wanted the Committee to know, that there is at least 10 percent, several thousand teachers and support professionals, non-State employees, whose future is dependent upon this Committee and others who will be working on long-term solutions for the State health insurance. The loss of a secure future is something that we are concerned about, and we hope to be part of the effort with you to make the solution something that is viable. When we look at those thousands of people and their families who do not have Medicare and will never have Medicare, it is important that we keep them in mind as we work toward solutions.

Assemblyman Claborn:
What you just stated, could you send us something to that effect in written form?

Terry Hickman:
We will put it in writing for you that beginning in 1986, the new hires were required to pay into Medicare, and those who were hired prior to 1986 did not pay into Medicare. So with no payment into Medicare, they never become eligible for Medicare. It would be for people who are into their 22nd year of service or more.

Assemblyman Munford:
I have been listening to this during the entire morning. I am glad that you came to present something on the side of the teachers. That was what I was most concerned about as I am a retired teacher. So when a teacher retires, what are the options he has in terms of medical care or program for them? They tell us that we are sort of on our own, and we select a provider, any provider we can find because the only program available to us through PERS is very expensive. I have not even inquired because I have a program, from my spouse, that covers me. If that was not available, what options would I have?

Terry Hickman:
As a retiring educator now, if you were not eligible for Medicare, you would have to look to your own district, or look to PEBP, or to fund your own through private companies that would provide insurance for you.

Assemblyman Stewart:
I would advise you to advise your teachers to get the 40 work quarters in, in addition to their teaching. That is what I did and I qualified for Medicare.

Chair Kirkpatrick:
Thank you, Mr. Hickman. I am sure by all the public comment, that people will now know where to talk to other folks, and I encourage you to give the Committee as much information as you can before we put all these scenarios together.

James T. Richardson, J.D., Ph.D., Nevada Faculty Alliance:
I represent the Nevada Faculty Alliance. I would first like to join the Committee and the Chair in thanking Leslie Johnstone and Jon Hager for a very helpful presentation. It helped me deal with some of these very complicated issues.

Good health care is very important to State employees. Yesterday, if you were listening to the presentation about the State of Nevada Local Government Pooled Long-Term Investment Account (NVEST) program, one of the speakers spoke about how important it is to maintain a good health care program because it is a big help in trying to recruit and retain teachers. That same comment goes for other areas of State employment. What we are doing this session with the PEBP plan is extremely important, not only to State employees, but also to others who are involved with the PEBP plan as non-State actives and retirees.

I want to go on record as applauding the actions taken by Governor Gibbons. I was heartened when he decided to take an amount of money and establish the trust fund. He made a very loud statement to two important groups: First, he spoke to the bond raters back in New York and said that Nevada is going to deal with this problem. As Leslie Johnstone said, Nevada is at the forefront with the recommendation to try to establish a trust fund. Secondly, Governor Gibbons also spoke very loudly to State employees and said "I think your health plan is important, and I want to try to preserve it." I was delighted to see that statement on his behalf and I hope that all will join in that.

This is a problem that has to be approached in a bipartisan manner; it is not going to be something that can be settled one party against another. I would like to pose a question that you might want to have addressed: When Andrew Clinger, budget director, talked about the trust fund, he used the amount $30 million and he also said that was only the General Fund amount that would flow into it. There would be another $20 million flowing from the non-State General Fund sources for a total of $50 million. I know I did not mishear Andrew, but maybe there has been some recalculation. According to Andrew, the bill was going to be written so that there would be a 1 percent tax on non-State General Fund payroll, generating $50 million. It is just that the actuary people need to have the right amount, so we need to get that clarified.

I was heartened this morning to hear a number of people trying to solve the problem by putting money into the trust fund in one way or another. The PEBP scenarios, to be frank with you, have frightened many State employees because of all the talk about cutting benefits, some of which are truly draconian, as has been noted. If you look at scenarios one, three, four, and eight, and you notice how flat the line gets in the long term, that means the cost is shifting to State employees and their dependents. So that is the policy decision; are you going to do that? I would urge you to take some care with, for instance, the Medicare one. I join Terry Hickman in his comments. Even post 1986, when we started paying the Medicare, some of you certainly understand that Medicare does not cover everything. It does not cover dental and vision, and there is no life insurance; so if you are talking about scenario eight, what do you do about losses that would accrue to people? Those scenarios have been very worrisome. I have gotten innumerable phone calls and emails about them and I urge you to continue to have the kind of conversations you are having today about how to build up the trust fund. I was delighted to read, Mr. Settelmeyer, your comment in the paper this morning, that one thing we might do when we have surplus revenues is to figure out a way to design a trigger, to pump some of those revenues into the trust fund to help shore it up. We will not always have surpluses, but when we do, this might be a very wise decision in terms of helping and encouraging State employees. Yesterday, you may recall, Leslie Johnstone spoke about excess revenues in the PEBP funds. Those vary, but it is worth noting that last session the amount of excess that was absorbed was over $40 million. It would have been nice to have addressed the problem then and put that $40 million perhaps into a trust fund that started two years ago and then was accruing for two years at the 8 percent level. It did not happen. There was a budget amendment that came into the money committees and all of a sudden the money went for other good causes. I am just pointing out that those funds that are accumulated in the PEBP funds come from the State contributions and from active contributions. So we actually had some money in that $40 million that went elsewhere.

A comment about Assemblyman Goicoechea's idea that Mr. Beers picked up on: I think the State employees, including the university folks I represent, have a big stake in this. I would like to suggest that you at least cost out that option, but with one important addition. When you take the 1 percent or whatever percent you have decided, for either new hires or all employees, they are paying the freight. I would encourage you to consider a match. According to the Aon Study, it would take, with the 2005 figures, about 6 percent of salaries to cover the liability. If the employees were contributing 1 percent and the State was matching 1 percent, you have a third of the liability covered; and then if you had some trigger ideas like you talked about when you used excess revenues, maybe we could get this thing pre-funded and not have to talk about it every session. I urge you to consider permanent solutions to putting money in the trust fund, and I would like to ask on behalf of the folks I represent and the employee and retiree groups here, when you do talk about those options, we would like to discuss them with you. Cutting benefits comes out of our hides and those of our dependents. I have worked for the university system for 38 years, and some of the solutions are not too palatable.

Martin Bibb, Executive Director, Retired Public Employees of Nevada:
I appear here today on behalf of our 8,000 members. Our folks come from not only State employment but city and county and school district and police, fire and other Nevada PERS-covered types of employment. We appreciate the remarks both previous speakers have made because they represent some of those same people.

Many years ago when the Public Employees Benefits Program was still known as the Committee on Benefits, Dr. Richardson served as chair of that group. So he comes with some serious background and experience relative to this issue. As somebody who has been representing Retired Public Employees of Nevada (RPEN) on this issue for 16 years, I suppose I do as well.

One of the items, for those who were not serving in 2001 and 2002, was that GASB was not even a consideration. In those days, this plan found itself $42 million in the hole, unable to pay claims, much less to consider expanding benefits or pre-funding future liabilities or anything of that nature. We applaud Mrs. Johnstone's presentation because it is thorough, and she has done an excellent job. This is a highly complex matter, and I know it is not a simple consideration for the members of this Committee. One of the things that we are concerned with is something that some of the members asked and that is what exactly other states are doing in trying to grapple with this situation.

In addition to anecdotal evidence, it would be nice to find out expressly and specifically how many are where we are, how many, if any, have, moved ahead to some pre-funding, et cetera; so that we can have a feel for where we are from a policy standpoint in Nevada versus others who are struggling with the same situation. It is not only states because local governments have to deal with this very same issue.

Another concern of ours has always been the accuracy of the numbers. I know everyone here is working hard with the recent request that went from PEBP for current new and accurate valuation. It will make the Committee's work far more meaningful because it will be based on something that is as current as possible. The same challenges have faced the private sector as well. The acronym there is Financial Accounting Standards Board (FASB). I know many of the Committee members are aware that there have been many effects not only on retiree and active health care benefits, but pensions as well. Some of the well-documented federal bankruptcy cases, such as United's $10 billion bankruptcy, certainly had an impact on the pensions and the health care and the lives of the people who were affected. Relative to the scenarios that were brought up, we too are concerned, and I believe Mrs. Johnstone indicated it might be an extreme to cut off subsidies to new hires. I would agree with that, and would state that it would also be extreme to cut off long-standing and existing subsidies to Medicare retirees. I know it does not make your job any easier, but I was heartened that you all are trying to find some hybrid solutions and solutions that reach out into areas that others had not discussed expressly. An employee contribution and, as Mr. Richardson said, an employer match could be a very helpful start in this. We look forward to joining with you and staying active in this debate as it continues throughout the Legislative Session. We think that whatever the decision is, it affects today's actives as well as today's retirees and Medicare retirees. Any solution should have some impact on all those groups but not exclusively one group.

Danny Coyle, President, Retiree Chapter, State of Nevada Employees Association; AFSCME (American Federation of State, County, and Municipal Employees) Local 4041:

Dr. Richardson and Marty Bibb made some of the points I was going to make. I would like to say that the presentation made by the PEBP staff was a good one, and I think that the PEBP has appreciated measurably since Ms. Johnstone took over as Executive Officer.

She mentioned that she was not sure how other states were doing, or whether others had implemented a pre-funding program. I would like to state that California Public Employees' Retirement System, (CalPERS), who administers the other retirement benefits, which would be the health insurance for the State of California, has almost put in place their requirement under GASB statement 45. They are in the process of setting up an Internal Revenue Code 115 Trust Fund and are accepting contributions from employers who wish to pre-fund health insurance. I have asked Ken Margie, the person administering the program for CalPERS, to send me some additional information, so hopefully, this information will be forthcoming so I can have copies for all of you in a timely fashion.

I would like to caution you not to obfuscate the requirements under GASB 43 and 45 with the requirements in GASB 27, which deals with the funding of the liabilities of retirement systems, with those on the health insurance programs. I know there are a lot of people out there who are trying to mix apples and oranges, but what we are talking about now is the health insurance and not retirement systems. I hope that before this session is over, this will be clear to all the people that we are talking about two different things.

Chair Kirkpatrick:
A point of clarification, tomorrow we will be hearing about the retirement system.

James R. Wells, CPA, Deputy Superintendent, Administrative and Financial Services, State of Nevada, Department of Education:
One of the things that Ms. Johnstone alluded to earlier was that this impacts local governments as well. I am going to talk specifically about school districts because there is a little caveat in the GASB 45 statements that could have a big impact on how they are treated statewide.

The State has a single plan, the PEBP plan. Every local government, other than a handful who are in the PEBP plan with their active people, has multiple plans. They have the one for their own health insurance plan and they have the one that was created under A.B. No. 286 of the 72nd Session. Since that program started for the A.B. No. 286 retirees in 2003, the school districts have had their premiums to PEBP funded through an appropriation from the Distributive School Account (DSA). In the current biennium approximately $19 million was set aside for that purpose. In the next biennium we are requesting almost $40 million in the Governor's recommended budget to pay for those same A.B. No. 286 premiums for the school districts.

Paragraph 32 in GASB 45 says that if one government guarantees payment for another government, the liability resides with the government that makes that guarantee. It goes on to specifically address a state that funds this for its teachers through the school districts. There is a possibility that because the DSA has continually funded these A.B. No. 286 payments since their inception, it guarantees these payments to the distributed school account. If that is true, then the liability for any additional amounts for pre-funding would go onto the state's financial statements.

Assemblyman Goicoechea:
I would challenge whether the State of Nevada is really on the hook because Washoe County clearly has the ability to fund retirement health care benefits for their employees and therefore not pay A.B. No. 286.

Marvin Leavitt, Chairman, Committee on Local Government Finance:
The local governments have essentially the same situation as the State does regarding the recording liabilities coming from the health insurance situation.

Local governments have the additional problem that if the money set aside to pre-fund this liability is to be shown as an offset against the liability, it has to be put in an irrevocable trust. Local governments by themselves are not in position to establish an irrevocable trust because what the governing board can do today, they can undo tomorrow. Because of that, the Committee on Local Government Finance has been working on preparing a bill that will provide the framework for the establishment of irrevocable trusts by individual local governments around the State and establish the parameters within which they will be governed. We have contacted the Governmental Accounting Standards Board because we know that what the Legislature does in one session, they can undo in another session. The Standards Board has indicated that they will accept an irrevocable trust, if the Legislature does approve it, since the individual local government does not have the right to change that. Once the money is placed in the trust, it is no longer under the control of the local government and cannot be used for any purpose other than providing health benefits for their retirees. This bill will provide similar language to the one that will come to you from the State, which will provide for the way that the monies have to be invested.

In the local government situation, we probably have a bigger problem as it relates to the investment of monies than you do in the State because we have 250 local governments around the State. Some of them are very small, and they are not in the position by themselves to prudently invest, which would include equities, and even perhaps real estate if you look at the PERS model. So we provided specific mechanisms for the investment of these monies. One is that they can be invested in a pool that might be established in the future by PERS or by the State Treasurer. We also provide mechanisms by which, if the local government is large enough and has the in-house expertise, it could establish one of these investment funds itself. I just wanted to make you aware that there is a bill coming on the topic you are discussing today.

Assemblyman Beers:
Mr. Leavitt, could you be sure that each of us gets a copy of the language of the bill prior to the presentation?

Marvin Leavitt:
I think that you will have plenty of opportunity to see it. Right now the bill is scheduled to be introduced into the Senate, and so it will go through that process before it arrives here.

Chair Kirkpatrick:
Mr. Beers, you may want to track it from the Senate side to see how it may change by the time it gets to the Assembly. I would like to recognize

Ms. Wallin who has sat through the whole presentation. It is important for our Constitutional officers to be part of the process. Ms. Johnstone and Mr. Hager, thank you very much for working so diligently over the week to prepare this. I have some Committee members who have asked if you could send the presentation electronically. Thank you to the Committee for sitting through this for the last two days; it is a very important issue. One last question for Ms. Johnstone, could you get to us in writing something about whether or not this will affect our bond rating? We just had our bond rating increased because we were doing so well. Is that something that is going to change sooner rather than later?

Leslie Johnstone:
I spoke last week with Robin Reedy from the Treasurer's Office because this is a common question. There is nothing that we can help out with definitively because the bond rating agencies will look at the credit rating from a variety of different aspects. How we are approaching the GASB liability is one of them, and the read from the Treasurer's Office was that the most important thing from their perspective, what they are hearing from the rating agencies, is that the jurisdictions do not ignore the issue, and that they work toward a plan. That does not necessarily mean pre-funding in the short-term, but showing some progress towards identifying how the situation will be approached.

Chair Kirkpatrick:
We need to have a plan in progress in order for that to change.

[Adjourned 10:19 a.m.]

RESPECTFULLY SUBMITTED:

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Emilie Reafs
Committee Secretary

APPROVED BY:

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Assemblywoman Marilyn K. Kirkpatrick, Chair

DATE:______________________________

EXHIBITS

Committee Name: Committee on Government Affairs

Date: February 13, 2007 **Time of Meeting: 8:00 a.m.**

Bill	**Exhibit**	**Witness / Agency**	**Description**
	A		Agenda
	B		Attendance Roster
	C	PEBP, Leslie Johnstone	GASB 43 and 45 PowerPoint slides