

**MINUTES OF THE
NEVADA LEGISLATURE'S
COMMITTEE ON INTERIM RETIREMENT AND BENEFITS
(*Nevada Revised Statutes 218.5373*)
January 25, 2006**

A meeting of the Nevada Legislature's Interim Retirement and Benefits Committee (IRBC) was called to order by Vice Chairman William J. Raggio on January 25, 2006, at 2:00 p.m. in Room 3137 of the Legislative Building in Carson City, Nevada.

COMMITTEE MEMBERS PRESENT:

Assemblyman Morse Arberry Jr., Chairman
Senator William J. Raggio, Vice Chairman
Senator Bob Beers
Senator Bob Coffin
Assemblywoman Ellen Koivisto
Assemblyman Bob Seale

LEGISLATIVE COUNSEL BUREAU STAFF PRESENT:

Mark W. Stevens, Assembly Fiscal Analyst, Fiscal Analysis Division
Gary L. Ghiggeri, Senate Fiscal Analyst, Fiscal Analysis Division
Bob Atkinson, Senior Program Analyst, Fiscal Analysis Division
Melinda Martini, Program Analyst, Fiscal Analysis Division
Brenda Erdoes, Legislative Counsel, Legal Division
Joel Benton, Senior Deputy Legislative Counsel, Legal Division
Cheryl Harvey, Secretary, Fiscal Analysis Division

COMMITTEE MEMBERS ABSENT:

None.

EXHIBITS:

Exhibit A: Agenda and Meeting Packet
Exhibit B: Handout titled "The Realities of Retiree Healthcare in Nevada in the Wake of GASB 43 and 45" - Agenda Item III-D, provided by Jim Wells, Chief Financial Officer, Public Employees' Benefits Program

I. ROLL CALL

Vice Chairman Raggio called the meeting to order and acknowledged committee members. He requested the secretary to take roll; it was determined that a quorum was present.

II. APPROVAL OF THE MINUTES FROM THE JANUARY 13, 2005 MEETING

Vice Chairman Raggio requested a motion for approval of the minutes from the January 13, 2005 meeting.

SENATOR COFFIN MOVED FOR APPROVAL OF THE MINUTES FROM THE JANUARY 13, 2005 MEETING OF THE NEVADA LEGISLATURE'S COMMITTEE ON INTERIM RETIREMENT AND BENEFITS.

ASSEMBLYMAN SEALE SECONDED THE MOTION, WHICH CARRIED UNANIMOUSLY.

III. PUBLIC EMPLOYEES' BENEFITS PROGRAM (PEBP)

- A. Report from independent certified public accountant as of June 30, 2005 (NRS 287.043).**
- B. Report on status and financial position of the Public Employees' Benefits Plan.**

At the request of Vice Chairman Raggio, Mr. James Wells, Chief Financial Officer, Public Employees' Benefits Program (PEBP), introduced himself and Nicola Neilon, CPA, from KBCA, LLC, the accounting firm for PEBP. He indicated he would present the financial statements and the historical trends in the meeting packet, Tab III-B, Exhibit A, and Ms. Neilon would present KBCA, LLC's audit of financial statements ending June 30, 2005, under Tab III-A of Exhibit A.

Mr. Wells referred members to his presentation, which started on page 53 of Exhibit A. He explained that pursuant to NRS 287.043, the PEBP board must appoint an independent certified public accountant to provide an annual audit of the program. The CPA must report the results of the audit to the board and to the Interim Retirement and Benefits Committee (IRBC) of the Legislature. This was the second year the financial statements were prepared by the PEBP staff in order to bring more timely information to both the PEBP board and to the committee. PEBP was the only agency with audited financial statements within 90 days of year end. Mr. Wells thanked the State Controller's office, KBCA, and vendors who continued to make this possible.

Mr. Wells reported the following statistics from the FY 2005 Financial Summary:

- Operating income exceeded expenses by \$22 million for the year ending June 30, 2005. This reflected both the reduction in large claims and overall plan utilization from the original budget submitted in 2003. Also, the excess represented savings from plan design changes that were implemented in 2003 and 2004 plan years.
- Claims expense for the year increased by 16.1 percent, or a little over \$19.4 million, from the prior year, but was still 4.3 percent, or \$6.2 million, less than it was in Fiscal Year (FY) 2003.

Vice Chairman Raggio questioned whether the figures were all as of June 30, 2005; Mr. Wells replied he was correct.

Vice Chairman Raggio asked if the presentation would include PEBP's current financial statements. Mr. Wells responded that financial statements as of September 30, 2005 and December 31, 2005 would be presented later in the presentation.

Continuing, Mr. Wells stated that:

- As of June 30, 2005, the net assets remained positive. The Incurred But Not Reported (IBNR) and the Rate Stabilization/Contingency Reserve were fully funded. PEBP continued to have more cash on hand than was required by the combination of these two Reserves.
- The initial estimates showed the fund balance would exceed federal guidelines by \$21.4 million. PEBP staff was currently working with the Department of Administration on the options available to resolve this issue.

Vice Chairman Raggio questioned what the federal guidelines suggested. Mr. Wells stated the federal guidelines suggested no more than 60 days cash on hand in addition to any IBNR Reserve amounts. PEBP was currently at about 75 to 90 days cash on hand and had requested an increase in the cash-on-hand allowance. Mr. Wells confirmed that 60 days cash on hand was ongoing.

Directing committee members to pages 56 and 57 of the meeting packet (Exhibit A), Mr. Wells indicated the Income Statement and Balance Sheet depicted condensed information from PEBP's June 30, 2005 financial statements. PEBP's operating revenues were up approximately 10.7 percent, largely due to the increase in the state subsidy from \$495.68 to \$558.07. Operating expenses were up from \$154 million to \$199.6 million; the largest drivers were claims costs that were up over \$19 million and the increase in the costs for the Anthem HMO in the north, which was over \$25.5 million.

Mr. Wells pointed out that the ending net assets were \$54.94 million, up from \$31.54 million in 2004. In accordance with NRS 287.0434 and 287.0435 and Government Accounting Standards Board (GASB) Statement 46, for the first time PEBP was actually restricting its assets in financial statements and limiting them to use for program purposes only. This decision was approved by the Attorney General's office, State Controller's office, and the state's outside auditor. The balance sheet showed increased cash and equivalents from \$48.9 million to \$77.7 million, which represented the cash on hand in the State Treasurer's office. The accounts receivable were approximately the same. The obligations under securities lending were \$44.28 million, representing investment shares and an offsetting liability created through a security lending program administered by the State Treasurer's office. Reserve for Losses Incurred But Not Reported (IBNR) liability increased from \$19.2 million in 2004 to \$23.8 million in 2005.

At Vice Chairman Raggio's request, Mr. Wells clarified that the IBNR Reserve was calculated based on utilization and rate of claims paid, i.e., how quickly the third-party administrator and pharmacy benefit manager turned claims around.

IBNR represented claims that had been incurred by participants, had not been submitted by providers to a third-party administrator, or had been submitted by the providers but not yet been paid.

Vice Chairman Raggio asked if an internal formula was used to determine the amount of Reserve PEBP would utilize. Mr. Wells replied that the actuaries prepared a triangulation report to determine the average number of days it took to receive and process a claim. The IBNR Reserve was calculated based upon that triangulation.

Continuing his report, Mr. Wells reviewed the graph on page 58 of Exhibit A. The graph reflected the breakdown of the surplus for FY 2005:

- \$3.3 million (15 percent) saved in large claims over \$10,000
- \$2.5 million (11 percent) saved in the medical utilization changes
- \$2.1 million (9 percent) in prescription drug utilization changes
- \$3.9 million (17 percent) in co-payment revisions
- \$3.9 million (18 percent) saved from the life, long-term disability, accidental death and disability coverages
- \$620,000 (3 percent) in dental utilization changes
- \$2.4 million (11 percent) saved in deductible changes
- \$2 million (9 percent) in out-of-pocket maximum changes
- \$900,000 (4 percent) saved in the vision plan
- \$600,000 (3 percent) saved for HMO consolidation

Directing the committee to page 59 of Exhibit A, Mr. Wells elaborated on the Operating Income and Expenses for FY 1999 through FY 2005. PEBP experienced two years of zero net income and a large loss in FY 2002; he assumed committee members were probably aware of the infusions of cash required during those three years. Fiscal Years 2004 and 2005 had been very good years, and income had exceeded operating expenses.

Mr. Wells referred to the graph found on page 60, Exhibit A, which reflected PEBP's claims expenses since 1999. PEBP's claims expenses steadily rose through FY 2003, when a significant decrease occurred. Mr. Wells noted that the expenses were rebounding somewhat in FY 2005, but they were still not up to the claims expense incurred in 2003.

The graph on page 61 depicted the cash balance of PEBP Fund 625, which was rising in accordance with the amount of money that PEBP held in the State Treasurer's office. Mr. Wells noted that FY 2002-03 was a point in time when PEBP actually borrowed money from the retired employees group insurance account to provide cash flow for the program.

Mr. Wells reviewed PEBP's Reserve levels and the percentage of the Reserves that were funded (page 62 of Exhibit A). In 1998, PEBP was minus 18 percent funded in Reserves. PEBP was fully funded as of June 30, 2004 and maintained Reserves

through June 2005. FY 2005 would be adjusted for the IBNR changes and for the changes to the catastrophic Reserve that would be submitted in PEBP's FY 2007-09 biennial budget.

Moving to page 63 of the meeting packet, Mr. Wells reviewed the Claims and Expense Loss Ratio. In 2005 PEBP had a claims loss ratio of 81.3 percent and an expense ratio of 7.4 percent, both of which were increases from 2004 when the claims loss ratio was 68.9 percent and the expense ratio was 6.5 percent. The claims loss ratio represented the increase in claims. The expense loss ratio incorporated salary, self-insurance administration costs, and the disease management plan that was implemented in 2005. Mr. Wells explained that typically, the claims loss and expense loss numbers would equal the premium; the goal was that the two would equal 100 percent of the premium revenue. If the two totaled less than 100 percent, the program would make money; if they were over 100 percent, the program would lose money. He pointed out that in 2002, PEBP spent 112 percent of its revenue on claims and another 9 percent on administrative expenses, which was one of the main reasons the plan was "upside down" at that time.

Referring to page 64 of Exhibit A, Mr. Wells reviewed the rest of the performance indicators as of June 30, 2005:

- The generic drug utilization was up from 52 percent in FY 2004 to 56 percent in FY 2005. The pharmacy benefits manager said the percentage rate was one of the best among his clients.
- Medical network utilization decreased from 92 percent in FY 2004 to 89 percent in FY 2005. PEBP had hoped to increase to 93 percent.
- Dental network utilization stayed flat at 71 percent.
- Appeals ratio per thousand participants decreased from .65 per month in FY 2004 to .52 per month in FY 2005.

Mr. Wells reviewed the first quarter results from page 65 of Exhibit A - Unaudited financial information ending September 30, 2005:

- Operating income of \$3.6 million on revenues of \$55.7 million.
- Claims cost of \$36.6 million for the quarter, which represented a 19.5 percent increase from FY 2005.
- Cash on hand of \$58.1 million as of September 30, 2005.

Mr. Wells remarked this was the time of year when claims were expected to be a little lower and would actually increase in the later quarters; PEBP was somewhat concerned with the increase of 19.5 percent, but the September numbers were staying in line with where the program expected to be budgetarily.

Mr. Wells moved to page 66 of Exhibit A, explaining that the Unaudited Income Statement as of September 30, 2005 compared the first quarter of FY 2005 to the first quarter of FY 2004. The operating revenues were down due to a decrease in the subsidy that was approved by the Legislature. The operating expenses were up from \$44.9 million to \$52.2 million, primarily due to an increase of \$6 million in claims.

Vice Chairman Raggio wondered if there was reason for concern or if it was just a spike in claims. Mr. Wells explained PEBP was watching claims very closely. PEBP's claims for December were in line with what they were projected budgetarily. PEBP was not overly concerned with the increase; it represented FY 2004 numbers being unexplainably low.

Mr. Wells noted the balance sheet on page 67 of the meeting packet indicated that cash remained almost unchanged. Actually, the cash was down a little over a million dollars, which also reflected the fact that PEBP had intended to use some of the excess cash on hand as of June 30, 2005 during fiscal years 2006 and 2007. There was an increase in the accounts receivable, which was due to changes in the way PEBP accounted for the retired employee's group insurance and the active employees' group insurance subsidies, which caused some delays in collecting monies in the first quarter. PEBP had corrected the problems and was moving forward.

Vice Chairman Raggio asked the meaning of the terms "Collateral on Loaned Securities" under assets and "Obligation under Securities Lending" under liabilities on page 67 of the meeting packet (Exhibit A).

Mr. Wells explained the Treasurer's office operated a securities lending program in which securities in its investment portfolio were loaned to others in return for assets, i.e., the Treasurer's office received collateral in exchange for loaning those securities. That collateral would become the assets that PEBP had on hand and the obligations under securities lending would be an offset. The program was never meant to gain a lot of money; it was just a tool the Treasurer's office used to loan its government-backed securities. The Treasurer's office received collateral such as CD's and commercial paper, in exchange for loaning.

Vice Chairman Raggio asked why it showed as an asset and then a liability. Assemblyman Seale clarified securities lending was started in the Treasurer's office when legislation passed in 1993. It was a mechanism for getting some incremental income. There were two ways to handle the reporting: one was to report the securities as PEBP had done, or net it and essentially it would not show at all. Assemblyman Seale approved of this particular method. Something was lent, which was a receivable, and something was borrowed at the same time. The differential between the interest rates obtained on the lending and the borrowing was what generated the revenue for the state. It was not a huge sum of money, but it was incremental revenue and relatively risk free.

Mr. Wells stated that amount would get bigger as the cash grew because the percentage of the securities lending program would become larger as the cash-on-hand increased.

Page 68 of Exhibit A showed PEBP's cash position and results of operations for the six months ending December 31, 2005:

- PEBP had \$67.9 million with the State Treasurer's office.
- PEBP had \$168,000 in the outside claims account.
- PEBP had a net loss for the six months ending December 31, 2005, of \$4.3 million on a cash basis. The net income would be revised in the December 31, 2005 financial statements as soon as they were completed.
- The claims expenses for the six months ending December 31, 2005 were \$72.7 million, up from \$65.1 million for the same period in 2004. \$2.4 million of claims were due to the Medicare Part B reimbursements, which were included as part of the claims expenses that were new for FY 2005.

Vice Chairman Raggio questioned why in the first three months of FY 06 there was a net income of \$3.6 million and a six-month loss of \$4.3 million. Mr. Wells replied the figures were displayed in different formats; one was on a cash basis and one was on a full accrual basis. The \$3.6 million as of September 30, 2005 was full accrual, whereas the \$4.3 million was on a cash basis. This reflected the fact that the December 2005 unaudited financial statements had not been completed. Mr. Wells believed that loss would be slightly over zero, as some money had been lost in the second quarter, but it should not be anywhere close to the \$4.3 million reflected on a cash basis.

Vice Chairman Raggio questioned if it was troublesome that at the end of six months PEBP was showing either a net loss or no net income compared to the last fiscal year. Mr. Wells replied that as part of PEBP's budget request in the 2005 Session, PEBP had projected that it would lose money over fiscal years 2006 and 2007 in order to use up some of the excess cash that it had on hand as of the end of June 30, 2005.

Vice Chairman Raggio asked if these figures would be affected by some adjustment in the plan. Mr. Wells replied that most of the plan design did not change for this fiscal year.

Based on the status of the net income as of December 31, 2005, whether it was on a cash or accrual basis, Vice Chairman Raggio asked where PEBP anticipated it would be at the end of the fiscal year with respect to net income. Mr. Wells replied that PEBP had projected that it would end FY 2006 with a net loss in the neighborhood of \$2 million to \$3 million, based on present plan design and potential income. It was also anticipated that there would be a bigger loss in FY 2007, somewhere in the vicinity of \$10 million to \$14 million.

Responding to Vice Chairman Raggio's question, Mr. Wells concurred it was better to utilize the Reserve and absorb the losses and not have to make as many adjustments in the plan design. Vice Chairman Raggio stated at some point PEBP would have to make adjustments, and Mr. Wells replied PEBP would address the issue during the next budget cycle. He explained that PEBP's budget presentation in the 2005 Session mentioned the fact that Reserves were going to be used down in the 2005-07 biennium, and the budget request reflected the fact that these Reserves would be used rather than built into the rate request.

Senator Beers noted in the first half of the year PEBP would make money as people met their deductibles. He asked if PEBP's target would be achieved. It did not seem to him that the loss in the second six months of the fiscal year would be less than it was in the first six months.

Mr. Wells explained that as of December 31, 2005, about \$12 million was still owed to PEBP in accounts receivable from the retired employees group account and the active employees group account. Adding this to the cash available would bring the Reserves to an \$8 million positive figure.

Senator Beers asked if the net change would be added into the accounts receivable. Mr. Wells explained the cash should have been coming in all along. There had been an issue with the way PEBP collected the retired employees' group insurance account, which had taken a few months to resolve. Mr. Wells thought that from a full accrual standpoint, PEBP was in perfect shape as of December 31, 2005. He believed that PEBP had made money the first six months, but he anticipated a loss of money the second six months. He stated that the program was financially in line with where he expected to be at this time.

Senator Beers asked if the timing issue with the accounts receivable would be resolved in six months; Mr. Wells replied it would. Senator Beers then asked what was expected for the two years for PEBP's target loss accrual. Mr. Wells replied that PEBP targeted about a \$15-\$16 million loss over the biennium on an accrual basis.

Senator Beers observed that in addition to the expected increase in healthcare rates due to medical inflation during the next biennium, rates would also have to be increased to recapture the operating loss that was being created in order to spend down the Reserves. He surmised that PEBP expected there would be a surprising increase in rates the next biennium. Mr. Wells clarified that PEBP's rates would go up in accordance with medical inflation. The largest increase in PEBP's budget request would be the active and retiree subsidy request, which would exceed the medical inflation. In the current biennium, PEBP gave credit to the agencies for using down the Reserves, and unfortunately, the agencies would have to make up the difference in the next biennium.

Directing Mr. Wells to page 57 of Exhibit A, Assemblyman Seale noted that there was an interesting item in liabilities: there was cash and equivalents of \$77 million, but there was a bank overdraft of \$43,000. Mr. Wells replied the figure represented

PEBP's outside bank account. It was a separate account from the State Treasurer's main account. The separate account was used by PEBP's third-party administrator (TPA) to pay claims. PEBP funded the account by transfers from the Treasurer's office. Mr. Wells remarked that PEBP had a very sophisticated way of tracking that outside bank account.

Assemblyman Seale asked if the account was maintained at a zero balance. Mr. Wells confirmed that the account was usually at a positive balance. Money was deposited in anticipation of the checks drawn on the account, which resulted in a positive balance. PEBP was under negotiations to change the third-party administrator account to a zero balance account.

Vice Chairman Raggio moved on to the report from the independent certified public accountant as of June 30, 2005 (NRS 287.043). Mr. Wells introduced Ms. Nicola Neilon, partner with KBCA, independent auditor, to discuss PEBP's audited financial statements as of June 30, 2005 (page 31, Exhibit A).

Ms. Neilon said she was happy to report that her firm had issued an unqualified opinion, which was commonly known as a clean opinion and was the highest level of assurance that could be given on a set of financial statements. The opinion indicated that the financial statements presented fairly, in all material respects, the financial position, the changes of the financial position, and the cash flows of the fund for the year in conformity with generally accepted accounting principles.

Since Mr. Wells had provided a detailed analysis, Ms. Neilon said her remarks would be brief. She reported that the year was a positive year; there was substantial net income and a substantial increase in assets, and the fund was in a very healthy condition. Ms. Neilon explained that KBCA's job as an independent auditor was primarily to test a sample of transactions, work with the external actuaries, work with the claims auditors, and examine all of the amounts to make sure everything represented the financial position fairly. PEBP was the only agency that prepared financial statements independently, and because of that, KBCA was able to present the financial statements to the PEBP board at its October meeting. The financial statements were incorporated into the state's financial statements as a whole, and they became part of the Comprehensive Annual Financial Report that the Controller prepared.

Ms. Neilon testified that part of KBCA's engagement was to look at the internal control systems. As part of that process, KBCA generated a report to determine if strengthening of internal controls was needed. Two recommendations were made in the prior year. The first was that the pay centers be reconciled, which was a monumental task. As of the date of the audit report, all of the major pay centers were being reconciled on a regular basis. Ms. Neilon commended PEBP for taking that step. Another recommendation KBCA made was in regard to stale dated checks. The external bank account, held by Bank of America, considered the check to be valid and payment was due even if the bank canceled the check. Checks were valid for 90 days. The bank did not communicate with the TPA to indicate those checks had been canceled. Accordingly, claim checks were not reissued, and a

liability was not recorded for the unpaid claims. NRS. 353.140 required the fund to honor all outstanding checks presented for payment within six years of origination. After six years, the unclaimed checks reverted back to the fund. During the current year, management researched the liability and determined a maximum amount that could be presented for payment. It was not certain how much of the balance would be honored. Management, after consultation with the State Controllers' office, determined the liability should be tracked internally and disclosed in the financial statements.

Ms. Neilon informed the committee that the estimated total amount of outstanding stale warrants less than six years old was \$931,000 as of June 30, 2005, and \$693,000 as of June 30, 2004. The State Controller's office and the external auditors concurred with the figures.

Vice Chairman Raggio questioned if a recorded liability should be made. Ms. Neilon responded there was an argument for recording or disclosing. If a contingent liability was probable and the amount that would be paid out could be estimated, the liability would be recorded. If it was not probable, then disclosure was permitted. In this case, it was felt that disclosure was appropriate.

Senator Beers asked if the items had been debited to expense and credited from cash. Ms. Neilon answered yes; however, when the bank reconciled the account it would automatically stale date the check. The check was recorded back into cash and was no longer an outstanding check.

In response to Assemblyman Seale's question, Ms. Neilon clarified cash was debited and expense was credited when the check was stale dated.

Assemblyman Seale questioned whether the unclaimed claims belonged to unclaimed property in the state, which was under control of the Treasurer's office. Mr. Wells responded that according to NRS. 353.140, at the end of the six-year period all claims would go back to the fund from which the funds originated.

Senator Beers asked if there was a history of percentage of those claims that were eventually paid. Ms. Neilon stated that the amount of the stale checks at any period of time could be estimated. What was not known was if a check would be presented for payment. The provider could have received payment from another source. In some cases, these checks would never be presented for payment. Potentially, some trending could be done to identify the percentage, but it would not be able to identify exactly which checks would be presented.

Mr. Wells told the committee that for about a year PEBP tracked exactly how many checks were canceled and then repaid. The numbers were not overwhelming. The checks were added to the list of unpaid checks.

Vice Chairman Raggio stated A.B. 286 required local government to subsidize retirees who participated in the program. He asked if the state subsidized retirees and billed the local entities each month. The city of Caliente and Caliente Public

Utilities and the Las Vegas Metropolitan Police Department (Las Vegas Metro) had not reimbursed the program for those subsidies.

Mr. Wells stated Las Vegas Metro owed about \$150,000, and the city of Caliente and Caliente Public Utilities district owed \$7,000 to \$10,000. The two entities, for different reasons, had decided not to pay PEBP for its participants in the program. Collection letters were sent and referred to the Controller's office for warrant offset. The Controller's office denied access to offset the payments due. The matter was referred to the Attorney General's office for further collection activities over a year ago and PEBP had yet to get any satisfaction.

Vice Chairman Raggio asked what reasons were given by the entities for not complying with the law. Mr. Wells replied Las Vegas Metro believed its bargaining unit was exempt from provisions of A.B. 286. The city of Caliente disputed that the participants were entitled to a subsidy despite the law saying to the contrary.

Vice Chairman Raggio confirmed the matter was referred to the Attorney General's office. He asked why Las Vegas Metro would be exempt from the law because of a bargaining unit.

Ms. Kateri Cavin, Deputy Attorney General, introduced herself. The Attorney General's office was following up on the legal ramifications of those two entities not making the payments as required by NRS 323.140.

Vice Chairman Raggio said it was troublesome for any agency or entity to ignore the law; other entities would question why they should have to comply.

Chairman Arberry asked when the Attorney General's office would make a decision as to what action to take. Ms. Cavin had contacted the Clark County District Attorney's office to discuss the possibility of doing a joint court action, not a declaratory relief action, but other relief that was possible under the statutes. The Attorney General's office and the Clark County District Attorney's office together would determine if the entity was subject to the provisions of Chapter 287 as revised in A.B. 286. She would advise the committee when she knew the outcome of her discussions with the Clark County District Attorney's office.

Senator Coffin asked why the city of Caliente, which was part of Lincoln County, which was having financial problems, was claiming it was not able to make the payments. Mr. Wells replied Caliente was not claiming anything to do with fiscal policy. The city was a member of PEBP's plan as an active participant, but for various reasons, the city paid for one retiree but refused to pay for the other five retirees in the plan. Part of the reason was a lack of interpretation of the statutes on the city's part.

Vice Chairman Raggio asked why the Controller's office was denying an offset from accounts payable. Ms. Cavin stated the Attorney General's office had worked on the possibility of going through the Controller's office through two separate methods. PEBP met with the Controller's office, but there was apparently some

misunderstanding as to what funds would be taken to do the offset. The Attorney General's office was also unclear as to how the offset process would work. The matter was denied twice, once through the Attorney General's office and once through the Controller's office. Litigation may be the next possibility.

C. Presentation on Public Employees' Benefits Plan options that will be considered by the Public Employees' Benefits Board for the 2006-2007 plan year.

Mr. P. Forrest Thorne, Executive Officer, Public Employees' Benefits Program (PEBP), introduced himself for the record. He noted that a presentation would be made at the February 2006 PEBP Board meeting on the plan design and rates for plan year 2007. The PEBP Board had requested certain plan options, and PEBP had provided information on what changes could be provided; one of the issues had to do with coordination of benefits for participants who also had Medicare coverage.

Mr. Thorne described the plan design options to the committee. There were three options available to the program:

- Maintenance of Benefits (Carve Out) - In determining a claim payment, the first step was to calculate the amount that would have been paid if the person had no Medicare coverage. The PEBP benefits were then reduced by the Medicare benefits paid for the claim. This methodology for coordinating benefits was in place during plan years 1991-1994, 1999 and 2006.
- Integration of Benefits - The self-funded plan excluded amounts paid by the primary health insurance (Medicare) and then calculated the benefits to be paid according to the normal plan rules. PEBP's plan would pay expenses not covered by Medicare after plan deductibles and coinsurance had been met. This methodology was in place during plan years 2000-2005.
- Regular (Full) Coordination of Benefits - PEBP's plan paid the difference between 100 percent of Medicare allowable expenses and what was paid by Medicare. The PEBP payment would not include reimbursement of the participant's annual deductible. This methodology for coordinating benefits was in place during plan years 1995-1998.

Mr. Thorne explained that under the Maintenance and Integration options, the Medicare participant was subject to the same maximum out-of-pocket level designated for each plan as all other participants. Under the Regular Coordination of Benefits (COB) option, the Medicare participant was subject to the PEBP deductible only and no additional expense.

Mr. Thorne referred to page 72, Exhibit A, which reflected the estimated costs of moving from the current Maintenance of Benefits to both Integration of Benefits and Regular COB. The impact of moving to the higher levels of coordination of benefits was greater on the non-state group because it had a higher percentage of participants who were Medicare retirees as part of the total group. For state actives

and retirees, the estimated cost of moving from Maintenance to Integration was estimated to be about \$2.4 million (1.3 percent) per year. The estimated cost of moving from Maintenance to Regular COB was \$7.5 million (3.8 percent increase).

Vice Chairman Raggio asked what the numbers would mean for the individual retiree. He understood moving to the Regular COB would result in a much higher cost to the state, but he wondered what the impact would be on the retiree. Mr. Thorne responded that for the majority of the Medicare retirees, the impact would be very small. For retirees with claims of any significance, there would be a big difference in out-of-pocket expense when a claim occurred. For example, if the retiree had \$10,000 in claims and Medicare paid \$8,000, under the current carve-out, the retiree would be responsible for the 20 percent balance. In the same scenario under Integration of Benefits, PEBP would pay 80 percent of the \$2,000 and the participant would be subject to 20 percent of the 20 percent. Under full COB, full compensation of the entire 20 percent balance would be paid, and the retiree would pay nothing, which was the reason for the additional \$7.5 million cost to the state.

Mr. Thorne added the impact on the smaller non-state group with a higher percentage of Medicare retirees in the group would be 10.6 percent rather than 3.8 percent, and everyone would have to pay the increase in the rates in order to pay for the additional benefit option.

Vice Chairman Raggio affirmed that the system was presently under the Maintenance of Benefits scenario, and the amounts cited were the additional costs for both state and non-state, both active and retirees included, if another option were chosen. Mr. Thorne indicated that Vice Chairman Raggio was correct, i.e., the costs for everyone would increase 3.8 percent in order to pay for the additional benefits under another plan.

Continuing on page 73 of Exhibit A, Mr. Thorne explained that beginning in plan year 2006, PEBP began reimbursing Medicare participants 80 percent of the monthly Medicare Part B premium. The action was taken in conjunction with changing the coordination of benefit methodology to Maintenance of Benefits in an effort to "level the playing field." This put every participant, regardless of status, in the same position when it came to payment of claims.

In looking at the coordination of benefits, Mr. Thorne said PEBP considered other options and logical links between coordination of benefits and reimbursement of Part B:

- Under Maintenance of Benefits COB, the plan would receive the full benefit of any participants having Medicare coverage. Therefore, reimbursement for 100 percent of Medicare would be consistent.
- With the Integration method of COB, the plan and the participant would share in the costs and a similar sharing of the premium costs would be appropriate.

- If the Regular method of COB were adopted, the participant would receive the full benefit of Medicare coverage, and therefore it would be appropriate for the participant to also pay the associated premium.

Referring to the Reserve levels, Mr. Thorne stated the recommended levels for rate stabilization and Incurred But Not Reported (IBNR) were trended out to June 30, 2006 by the Aon Consultants. The IBNR was projected to be \$23,009,651. For the rate stabilization, a Reserve of \$25,517,809 was projected. Those amounts, compared to the legislatively approved budget, would have an IBNR Reserve of \$19.2 million and a Reserve for rate stabilization of \$24.1 million (for a total of \$43.3 million) as of June 30, 2007. Additional Reserves were not anticipated, as PEBP set up its rate structure and subsidy policies to coincide with the biennial budgetary cycle. PEBP would obtain the actuarially established IBNR and use that in the budgetary process for the next biennium. The current IBNR in the budget was set June 30, 2004.

Mr. Thorne further explained the wellness, disease management, and disincentives for at-risk behaviors programs. The board had requested recommendations regarding what additional resources would be effective in enhancing the participation in the plan's wellness program, as well as what incentives could be provided to increase participation in PEBP's disease management program. Mr. Thorne cited some of the challenges in complying with federal requirements:

- American with Disabilities Act (ADA),
- Continuation of coverage, and
- Privacy.

Mr. Thorne stated PEBP would not anticipate that actions regarding either wellness or disease management would have a significant impact on overall costs to the plan, and the impact of the disincentives for at-risk behavior was uncertain.

Continuing, Mr. Thorne moved to the subject of Cost and Rate Structure. Aon Consulting had completed three sets of rate calculations using the different option combinations identified regarding the coordination of benefits and Medicare Part B reimbursement levels. The current rates were provided on page 77 of Exhibit A. The rates presented were the total amount and did not represent the cost sharing between the employer and the employee/retiree. The actual rate calculations, which would be presented at the March PEBP Board meeting, would also incorporate the budgeted drawdown of the plan's current surplus and the budgeted increase in the state subsidy.

Mr. Thorne informed the committee that when comparing the rates for each option to the current rates, there was a wide disparity between participant tiers on the increase or decrease in rates. For example, the Participant Only tier for state actives would increase 22 percent, while rates for all other tiers of state actives would increase 2 to 5 percent. PEBP believed this was a function of the predictive modeling technique by tier and the same end result could be achieved, with more

stability, by applying the composite rate increase to each of the current rates at each tier.

Mr. Thorne advised the committee that plan year 2007 would represent the third year in which predictive modeling would be employed. Page 75 of Exhibit A showed the composite rates for the current plan year. The graph showed different combinations of COB in Medicare Part B reimbursement.

In conclusion, Mr. Thorne stated staff would recommend that the board approve option number two concerning Medicare integration and the current 80 percent Medicare Part B reimbursement.

D. Presentation on the actuarial valuation of post-retirement health benefits provided by the state of Nevada and related discussion concerning Statement Numbers 43 and 45 of the Governmental Accounting Standards Board.

Mr. James Wells, Chief Financial Officer, Public Employees' Benefits Program (PEBP), re-introduced himself and referred members to the handout "The Realities of Retiree Healthcare in Nevada in the Wake of GASB 43 and 45," (Exhibit B). Mr. Wells explained the two standards for Other Post-Employment Benefits (OPEB) issued by the Governmental Accounting Standards Board (GASB) were:

- GASB 43 (Applies to the plan effective FY 07)
 - ❖ Uniform Reporting Standards for the plans
- GASB 45 (Applies to the employers effective FY 08)
 - ❖ Standards for measurement, recognition and display of OPEB expense and related liabilities.
 - ❖ Additional note disclosures and Required Supplementary Information.

Mr. Wells explained what was included in OPEB: Healthcare (medical, dental, vision, Rx), and other benefits not offered through a pension plan (e.g., life insurance, disability, LTC, etc). Not included in OPEB was an early retirement inducement or conversion of sick pay accounts to pay for post-retirement healthcare accounts. GASB realized the current accounting standards failed to recognize the cost of OPEB when services were rendered and did not identify the value of OPEB "earned" as a result of employees' past service. The new rules changed from a "pay-as-you-go" to accrual accounting for OPEB.

Mr. Wells explained the accounting requirements were similar to the Financial Accounting Standards (FAS) pronouncement 106, which affected the private sector and was structured similar to GASB pension accounting and reporting standards. Moving to page 6 of Exhibit B, Mr. Wells said with the changes to the financial statement reporting, the estimated annual required contribution was \$12,000 under the full accrual method versus a \$10,000 "pay-as-you-go" cost.

Mr. Wells further explained that under the GASB 45 rules, after FY 08, the fund statements on a modified cash basis would not change at all. The

\$10,000 expenditure would still show offsetting cash. There would be a \$12,000 expense on the government-wide financial statements. The difference would be \$2,000 recorded as a liability, reflecting the amount of under-funding for the OPEB expense for the current year.

Mr. Wells referred the committee to page 7 of Exhibit B, pointing out the five potential misconceptions about implementing GASB 43 and 45:

- GASB standards would require advance funding of OPEB. Not a true statement; states and local governments would still be able to “pay-as-you-go;” the only difference was OPEB required it recognize the liability for the difference.
- OPEB would wipe out General Fund balance overnight. OPEB was only shown on the full accrual government-wide financial statements. The fund’s financial statements were not affected by the pronouncements and the liability would not show on the financial statements. The General Fund balance would not be wiped out.
- Government would have to report a liability for OPEB previously earned all at one time. This was untrue, because if the government funded its annual required contributions, it would have a 30-year window to pick up that previously earned cost.
- No written agreement means no OPEB. False statement; if there was a substantive plan as understood by the employees/retirees and employers, then an explicit and/or an implicit subsidy may exist.
- No OPEB if retirees pay their full healthcare premium. Again, this was untrue because if actives and retirees were commingled together, it would create an implied subsidy for the retirees. It was required to be reported under the new GASB rules.

In answer to a question from Senator Beers, Mr. Wells stated the fund balance would not be a negative balance, because it would not actually go into the fund’s financial statements. It would go on the entity-wide financial statement. At some point, if the annual required contribution were not funded, the entity-wide financial statement would reflect a negative balance.

Senator Beers asked if the funding did not come in the first year, would expenses exceed PEBP’s revenue on the statewide financial statement? Mr. Wells did not know what the actual dollar difference would be between “pay-as-you-go” methodology and the accrual basis.

Mr. Wells explained the dollars must go into a trust fund to count as a pre-funded dollar. The self insurance trust fund was an internal service fund and would not qualify. Legislation would be necessary to create the trust fund. There would be no liability on financial statements if Annual Required Contribution (ARC) was pre-funded.

Mr. Wells continued, saying GASB's approach was that OPEB was a form of compensation to attract and retain employees. It had a long-term horizon, which began at date of hire and continued until the retiree died; the typical time period would be 50 to 70+ years. The GASB rules applied to single employer or agent multiple employer plans and were an effort to:

- Project future benefit payments,
- Discount projected amounts to today's dollar value, and
- Allocate cost rationally to years of employee service.

Mr. Wells noted the historical costs were allowed to be amortized up to 30 years before the full amount appeared on the financial statements.

In response to Vice Chairman Raggio's question, Mr. Wells stated no reportable income was required by retirees.

Mr. Wells said PEBP was governed by NRS Chapter 287, which established an internal service fund. NRS 287.046 included the provisions for both providing retiree health benefits and health insurance subsidies. Session bills reestablished retiree subsidies every biennium.

Mr. Wells reviewed the differences between Defined Benefit and Defined Contribution plans. By going to a defined contribution benefit, the OPEB costs would be reduced. PEBP's plan was a Defined Benefit plan. The plan was like PERS and promised a future benefit. The state risked the burden of the investments not covering expenses. The Defined Contribution plan was like the state's deferred compensation plan. The state would make the payment and the retiree was liable if the plan was not sufficient to provide full benefits.

Continuing on Page 12 of Exhibit B, Mr. Wells explained an actuarial analysis was required every two years for plans with membership greater than 200, or if significant changes were made to the benefits.

Mr. Wells stated the actuarial valuation of OPEB plans required:

- Demographic assumptions (i.e., retirement rates, withdrawal rates, mortality rates).
- Economic assumptions (i.e., medical trend, discount rate, future increase in state subsidy rates).
- Selection of an actuarial funding method.
- Selection of an actuarial asset method.
- Determination of the substantive plan.
- Determination of any implied subsidy.

Referring to page 15 of Exhibit B, Mr. Wells explained the terms that would be used.

- Present Value of Benefits (PVB) or Expected Post-Retirement Benefit Obligation (EPBO) was the present value of the cost to provide future benefits based on the assumptions of the plan. This was the total projected liability for all current employees and retirees, and the amount included the unfunded actuarial accrued liability as well as current and future service costs that would be earned by current employees. The estimated amount was between \$1.75 billion and \$4.44 billion.
- Unfunded Actuarial Accrued Liability (UAL) or Accumulated Post-retirement Benefit Obligation (APBO). The UAL was the portion of the future benefits already earned by current employees and retirees. The amount could be amortized or “financed” over a maximum of 30 years and could be based on a level percentage of pay (used by PERS) or a level dollar amount. Based on the actuarial evaluation report, the UAL was estimated at between \$1.35 billion and \$2.64 billion.
- Service Cost was the actuarial valuation of benefits earned by current employees during the year. Based on the actuarial valuation report, it was estimated between \$51.6 million and \$152.4 million.
- Future Service Costs - the present value of all future one-year service costs that would be earned in the future. The estimated amount would be between \$350 million and \$1.65 billion.
- Annual Required Contribution (ARC) was the current year Service Cost plus the current year amortization of the unfunded accrued liability (1/30th of the original actuarial accrued liability). The amount was estimated to be between \$119 million and \$222 million.

Mr. Wells explained the graph on page 19 of Exhibit B was an attempt to display the whole picture of the Annual Required Contribution. The UAL was the amount already earned by current employees and retirees; the Service Cost was the amount earned in the current year; and the Future Service Cost was the amount to be earned by current employees in the future. Adding the amortization of the UAL and the Current Service Cost would result in the Annual Required Contribution.

Mr. Wells said there would be some important considerations for the Legislature in the 2007 Session. The first and most important would be whether or not PEBP could afford to pre-fund the liability. The second issue would be the funding methodology used to calculate the GASB 43 and 45 expense, selection of amortization periods and actuarial assumptions. If the Legislature desired plan design changes or changes to the retiree subsidy, those would need to be considered, as well as how to deal with the implicit subsidy and the commingling issue.

In response to Vice Chairman Raggio's question, Mr. Wells stated most state governments had subsidization of retiree healthcare. Vice Chairman Raggio asked

what the liability would be if new hires were not eligible for post-employment subsidization. Mr. Wells replied that PEBP had requested the actuary to do a sensitivity analysis.

Mr. Wells stated GASB did not require an entity to pre-fund. The choice was up to the state. The largest impact was the discount rate used to determine the liability. If the state did not pre-fund, by GASB rules, it would have to use the internal rate of return of the entity, which would be between 3 percent and 3.5 percent. If the state did pre-fund, it could use a long-term rate of return, which could be 8 percent. The difference was in the discount rates, which created an anomaly where two plans with exactly the same benefits and exactly the same people existed, but one was pre-funded and one was not. The pre-funded plan would have a lower liability (EPBO) than the non pre-funded plan because the pre-funded plan would be able to use a higher discount rate in determining its present value of benefits. If the state used a 3.5 percent discount rate, the liability would be \$4.4 billion; if the state had a discount rate of 8.0 percent, the liability would be \$1.75 billion.

Assemblyman Seale expressed concern that one of the rates was based on the ability to invest in the equity markets and the other was based on the ability to only invest in the income markets. If his observation was accurate, he wondered if it would be to the Legislature's advantage to draft legislation to give the trust fund the ability to invest in equity markets, as was done with the prepaid tuition program. Mr. Wells agreed with Assemblyman Seale, adding that if the Legislature limited the investments of the fund to the same investments the Treasurer's office could make, no gain would be made by pre-funding.

Continuing, Mr. Wells said that other pre-funding considerations were that the state should select a funding policy that reflected its fiscal goals. The state would eventually have to determine whether it could afford to pre-fund the benefit. If the state could pre-fund, a trust fund would have to be set up, allowing it to invest in the additional equity markets. Another consideration for pre-funding would be the impact on bond ratings and borrowing costs, which was the negative aspect. Mr. Wells said it was PEBP's feeling in initial discussions with the bonding agencies that the liabilities would have an impact; however, because the effects were going to be spread so wide across the board, there was some speculation that it may not have as big an impact on the bond ratings as was originally believed.

Mr. Wells said the OPEB would require a selection of funding method. Six funding methods were allowed by GASB. Benefits were allocated over time, so the amount earned in the past was split and the amount earned in the future was also split, but all methods ultimately came back to the same place. The plan expense would vary based on the funding methodology used to split the liability between past and future service, and also the length of period of time over which unfunded liabilities were amortized. Under the aggregate method, there would be no split between past and future service, and the annual contribution would be \$223 million. Under the entry age method using a 30-year amortization, the contribution would be \$119 million and a 10-year amortization would create a \$208 million annual required contribution. Mr. Wells said it was important to remember that it was unclear when the past

liabilities and earnings would be fully funded. At what point in the future would PEBP be paying out more if it continued to “pay-as-you-go” versus the pre-funding model?

Mr. Wells said when the actuarial assumptions were selected, it would be prudent to be consistent with the pension evaluations because the participants who were in PEBP were a subset of the participants who belonged in PERS in general. Some of the demographic assumptions included the age of retirement, rates of termination and rates of mortality. Most economic assumptions were unique to the OPEB valuation. The economic assumptions with the most impact were initial claims and premium rates, medical inflation trends, rates of increase in retiree contributions, discount rates and salary scales.

Mr. Wells explained that GASB 43 and 45 basically reflected the state’s liability, which could be decreased by lowering the state’s obligation. Lowering the state’s obligation could occur by:

- Lowering the contribution to current benefit levels; maintain, not increase the subsidy in future years.
- Lowering the current benefit levels and keeping the state’s relative contribution percentage the same.
- Closing the plan to new hires, which the Governor proposed during the 2005 Legislative Session.

In conclusion, Mr. Wells discussed the implicit subsidy or the “hidden liability.” If PEBP combined or commingled the experience and rating of all actives and retirees, an implied subsidy would be created because typically the active people were younger and healthier and cost less to insure than their retiree counterparts. The difference was considered an implied subsidy. If PEBP commingled the actives and non-Medicare retirees and segregated out the Medicare retirees, an implied subsidy would still exist because the actives would be subsidizing the middle-aged retirees between 50 and 65 years old. If the non-Medicare and Medicare retirees were commingled into a single pool and the actives were left out, the implicit subsidy would be eliminated, because those retirees would balance each other out.

Vice Chairman Raggio thanked Mr. Wells for his complete and informative presentation. There were obviously many questions and issues to be dealt with – sooner rather than later. He asked for questions from the committee.

Assemblyman Seale asked if the discount rate of 8 percent was comparable to the expected return of the Public Employees’ Retirement System. Mr. Wells replied it was. Assemblyman Seale said he understood the assumptions were just the state’s responsibility without any consideration of the local governments, and he noted that was a huge problem. He asked if any consideration was given by PEBP to funding the unfunded liability through bonding. Mr. Wells replied a meeting had been held with a bonding entity, which did not recommend bonding at this time.

Addressing a question from Mr. Arberry, Mr. Wells stated a majority of the states were not pre-funded. Mr. Arberry questioned how the bond rate would be impacted if the state pre-funded half of the plan. Mr. Wells replied PEBP was not sure what the impact would be on the bond rating. The rating agency had said the state needed to manage the liability. The program was very new. The rating agency would not grade down the state's obligations if it did nothing the first year. If the state did nothing other than pre-fund over the next 20 to 30 years, the rating agency would take that into consideration. If the state did not do something to manage the liability, eventually the rating agency would look at that in a negative way. It would be used in factoring the state's bond ratings.

Assemblyman Seale remarked that a couple of states had contacted him to consult about issues regarding GASB 45. The rating agencies were not going to be happy if the state did nothing at all. Total pre-funding was not a requirement. Having a definitive program in place was going to make huge difference in terms of the bond rating. The state should do everything it could to continue to protect its rating.

Ms. Koivisto questioned if Medicare Part D would have coordination of benefits for Medicare retirees. Mr. Wells answered the board had elected to go with the drug subsidy option. PEBP had no coordination with Medicare Part D. PEBP was asking the retirees to maintain their benefits and not enroll in Medicare Part D, which would result in a subsidy in the current plan. At this time, no direct plan had been made as to how to use that money going forward. Mr. Thorne indicated the agreement to coordinate with Medicare Part D would have more of a negative impact on the cost to the Medicare participant.

E. Status report on the Legislative Commission's Committee to Study the Public Employees' Benefits Program.

No verbal report was given.

IV. PUBLIC EMPLOYEES' RETIREMENT SYSTEM (PERS)

Ms. Dana Bilyeu, Executive Officer, Public Employees' Retirement System (PERS), introduced herself and referred committee members to page 139 of the meeting packet (Exhibit A).

A. Approval of executive staff salaries (NRS 286.160).

Ms. Bilyeu explained that pages 139-155 of Exhibit A included information relating to the Retirement Board's process, as well as a 2004 memorandum prepared in advance of the January 2005 Interim Retirement and Benefits Committee meeting. Also included was a memorandum requesting approval of Retirement Board-adopted pay schedules for non-classified staff for Fiscal Years 2006 and 2007. Each of the recommended salary changes reflected the equivalent of a single step increase in each of the two years of the biennium. The steps had been

modified in keeping with board policy to include the cost-of-living adjustments authorized by the Legislature.

Ms. Bilyeu introduced the PERS Board of Trustees' chairman, Mr. Mark Balen, who would provide testimony concerning the salary request. After Mr. Balen's presentation, Ms. Bilyeu said she would review the proposed step increases for the positions in the non-classified service of the system.

Mr. Mark Balen, Chairman of the Board of Trustees of the Public Employees' Retirement System, explained that staff had provided an updated memorandum of pay schedules for the committee's review based on the approval of the budget for the 2006-07 biennium. The Board of Trustees was unanimous in its approval of the pay scales adopted for the non-classified members of PERS' staff. He said the area of compensation had been of great importance to the board, because the members believed the quality of the staff was one of the key elements of the Retirement System's continued success over the long term. The goal of the board was to make salaries competitive for professionals in the area and provide incentives for retention; the board also focused on succession management.

Mr. Balen referred to the schedules on pages 141-142 of Exhibit A, explaining that the schedules incorporated changes to the salaries of all seven non-classified positions. The system's budget reflected orderly progression through the steps of each of the non-classified staff members. The additional steps in the pay scale widened to the range of a 44 percent differential between the lowest and highest steps for each position. Mr. Balen said the model used was the nine-step approach implemented in the pay scales for state service. He reiterated that the Retirement Board was united in its desire and responsibility to maintain superior staff and compensate them accordingly, which would inspire retention and effective recruitment. The Retirement Board-approved schedule for executive pay would accomplish both of these goals in a fiscally responsible manner. On behalf of the board, Mr. Balen requested that the committee approve the recommended modifications.

Ms. Bilyeu introduced other Retirement Board members in attendance: Charlie Sylvestri, former board chairman, and board members Warren Wish and Purisimo Hernandez.

Ms. Bilyeu referred to the memorandum in the meeting packet (Exhibit A) which described the progression of each position in the non-classified service of the Retirement System and its respective salary range. Funding for the salary changes was included in the proposed budget and approved by the money committees during the 2005 Legislative Session. The recommended steps are summarized below:

- Executive Officer - Step 6 in Fiscal Year 2006 and step 7 in Fiscal Year 2007.
- Operations Officer - Step 4 in FY 2006 and step 5 in FY 2007.
- Investment Officer - Step 7 in FY 2006 and step 8 in FY 2007.

- Assistant Investment Officer - A new hire who is currently paid at step 2 of the range and will continue to be paid at step 2 in Fiscal Year 2006; may be moved to step 3 in FY 2007.

By way of background, Ms. Bilyeu explained that the Retirement Board had adopted nine-step pay ranges for each of the positions in the non-classified service of the System. This expanded the salary ranges from six steps to nine steps for the four officer positions at the system. The board also adopted new nine-step pay schedules for the Manager of Information Systems, the Administrative Analyst and the Administrative Assistant.

Ms. Bilyeu noted that the memorandum provided to the committee prior to the January 2005 meeting (page 147, Exhibit A) summarized the salary research conducted at the request of the board. Based upon its review of the research, the board determined that the current pay ranges for the Executive Officer, Investment Officer, and Operations Officer would be in line with similar positions, both locally and nationally, with the addition of three steps to increase the range of the schedule. Each of the new steps was set at the same percentage increase as the original six steps of the pay scale. Each incumbent in these positions retained their prior step in the schedule with proposed one-step increases at the beginning of each fiscal year in the biennium. The Assistant Investment Officer pay range was also expanded from six steps to nine.

Continuing, Ms. Bilyeu said that new pay ranges were developed for the Manager of Information Services, Administrative Analyst and Administrative Assistant positions. The new pay ranges were derived from the officer pay schedules by backing down steps. The pay ranges were derived in this fashion to provide for succession planning purposes and to be consistent with the purpose behind creating these positions as non-classified statutory positions. The new schedules resulted in all of the executive positions now having nine steps and being interrelated to reflect the duties and responsibilities of the positions and the management structure of PERS.

Ms. Bilyeu concluded her remarks and offered to answer questions from the committee.

Assemblyman Seale recalled previous comments he had made regarding his belief the staff could not be paid enough for what they did. However, he continued to be concerned about the salaries as they related to other positions within state government, particularly those within the Treasurer's office, which had similar duties, specifically in the investment area; he would prefer to see a balance among the positions.

Chairman Arberry remarked that there would always be some imbalance, and the Legislature had always attempted to balance and equalize salaries where possible. He added that Assemblyman Seale's comments and concerns were well taken.

There were no other questions.

VICE CHAIRMAN RAGGIO MOVED TO APPROVE THE RECOMMENDATIONS OF THE PERS BOARD'S PROPOSED SALARIES FOR BOTH THE EXECUTIVE OFFICERS AND NON-CLASSIFIED PERSONNEL.

ASSEMBLYWOMAN KOIVISTO SECONDED THE MOTION, AND IT WAS UNANIMOUSLY PASSED.

B. Review of actuarial valuation report for the PERS fund as of June 30, 2005.

Ms. Bilyeu referred the committee to Tab IV-B of the meeting packet (Exhibit A), which was a review of the non-rate setting year actuarial valuation of the Retirement System. By statute, contribution rates were modified biennially based on the results of the even-numbered years' valuations. Since this was an odd-numbered year, the rates would not change based upon this report.

Ms. Bilyeu remarked that the memorandum found on page 159 of Exhibit A reviewed the elements upon which the valuation was based. It also set forth the most significant findings of the valuation. According to the five-year smoothing process adopted by the Retirement Board, the valuation recognized the last significant piece of the losses experienced in the down market cycle from 2000 to 2002. The system had experienced a loss due to higher-than-expected actual retirement experience. Ms. Bilyeu explained that the retirement assumption was an age and service related assumption, so there were groups of individuals who were expected to have certain things happen for them when they retired, e.g., at what ages and how much service they would have. At the actual younger ages, the system experienced losses that were not expected, which was the first significant departure from the Retirement Board's assumptions related to retirement. Retirement assumptions were looked at over three- to five-year trends, which was something Ms. Bilyeu said would be looked at very closely with the coming two valuations to ensure that it was not just an anomaly.

The funding policy adopted by the Retirement Board in 2004 was in its second year and was working as expected to smooth contribution rate volatility. For the benefit of the new members of the committee, Ms. Bilyeu said she wanted to take a moment to review the tools that were used by the board to add stability to the contribution rate, as a principal goal of the board was to provide predictable rates to the benefit of the members and employers who shared equally in the cost of funding the system.

As previously mentioned, the board adopted a five-year asset smoothing process in the early 1990s, which was designed to smooth market returns. The method required that both gains and losses be brought into the valuations over rolling five-year periods (basically 20 percent at a time). This metered both rapid gains and rapid losses in the system. Ms. Bilyeu said that since employers and employee members shared equally in the cost of the program, the volatility that the market brought to the contribution rate was something that PERS wanted to meter, because every member of the program paid half the cost.

Other volatility tools adopted by the board included the entry age normal valuation method, which was used because it was the most stable process used to value pension systems. Ms. Bilyeu said she could not speak to the healthcare area, but for pension systems, that method was uniformly used; there were a few pension systems in the country that used others, but for the most part, entry age normal was used in the industry. It provided for a contribution rate that paid for the accumulation of the yearly cost of the benefit accrual, also known as the normal cost. The statutory contribution rate mechanism put into place in the early 1990s provided stability to rates because it only allowed contribution rate changes every other year.

Ms. Bilyeu noted that Laura Wallace, PERS Investment Officer, would review the investment portfolio and the board's adopted approach to asset allocation and investment decisions, which was designed to meet rapid fluctuations in market return, primarily through asset diversification.

Continuing, Ms. Bilyeu again pointed out that this year's valuation recognized the last sizeable piece of the market losses included in the valuation. As these losses were brought into the valuation, they affected the funded ratio of the program. One of the exhibits to the staff memorandum (page 164 of Exhibit A) showed the reduction in the funded ratio. Since the top of the market cycle, the funded ratio had been reduced by less than 9 percent (approximately 8.9 percent). In essence, the funding levels had returned to 1997 funding levels.

Ms. Bilyeu referred committee members to the exhibits on pages 161 and 162 of Exhibit A, which summarized the results of the 2005 valuation. The employer-pay rate for regular members was approximately 75 basis points higher than was currently being paid into the system under a statutory rate setting mechanism. She explained that members and employers currently paid a combined rate of 19.75 percent under that particular program. For police/fire, the actuarial rate was approximately 1.25 percent higher in the 2005 valuation than the current rate. Again, the principal findings of the report impacting these rates were the recognition of those previous years' losses.

Ms. Bilyeu said immediately following the rate charts were several charts that would assist committee members in their review of the system, including the ratio of active members to retirees, the funded ratio, and the average profiles of active members and benefit recipients of the system.

Chairman Arberry noted that the percentage of the system that was funded went down from 84.7 percent in 2000 to 75.8 percent in 2005. He asked Ms. Bilyeu if there would be an increase in the percentage that the system would be funded in the future. Ms. Bilyeu responded that the last remaining piece to be brought in for the market losses for the next year's valuation for the prior period would be approximately \$116 million for the regular fund and approximately \$23 million for the police/fire fund. She said the actuary acknowledged there would be a slight reduction in funded ratio and a potential slight increase in contribution rates. She added that years of positive market returns were being brought in as well; Laura Wallace would be speaking to the status of that particular area. Ms. Bilyeu said that

if the assumptions were matched as of today, there would be a slight reduction in funded ratio based on the \$116 million loss that would appear next year for the regular fund and the police/fire fund of \$23 million.

Vice Chairman Raggio referred to page 163 of Exhibit A and noted that the ratio of actives to retirees had decreased to 3:1. He asked Ms. Bilyeu if she anticipated the ratio becoming lower in the years ahead. Ms. Bilyeu replied the national trends were generally decreasing based upon the number of baby boomers that would be retiring, as well as the individuals who would be entering the workforce. She speculated there would be continued reduction in the ratio over time. For purposes of funding the program, because the entry age normal accrual method of paying for benefits was used whereby assets were being set aside today for every individual in the program to pay those benefits into the future, the ratio, while very important to look at, did not have the same effect on the program as seen on the impact of the Social Security system, i.e., today's generation of workers was paying for today's generation of retirees. Since assets had been set aside for the future and the system used the power of compounding to pay for benefits, the ratio was important to consider, but it was only one piece of the funding equation.

Vice Chairman Raggio observed that the possibility of enlarging the availability for early retirement could affect the ratio. Ms. Bilyeu agreed, noting that any type of benefit changes would affect the normal cost of the accrual as it went forward.

Assemblyman Seale asked how large the unfunded liability was in raw dollars. Ms. Bilyeu replied that for both the aggregate police/fire and regular fund it was approximately \$5.6 billion. Assemblyman Seale remarked that amount would be in addition to the approximately \$4 billion reported by the Public Employees' Benefits Program.

Vice Chairman Raggio asked what the unfunded liability would be today if the system had stayed on a whole system rather than a 30-year ruling computation. Ms. Bilyeu replied that the single year difference in the unfunded liability would not be significantly reduced from the old funding method to the new funding method. The greatest impact would be in the actuarially required contribution to meet that funding schedule; a fairly significant increase in those contribution rates would have been seen.

Senator Beers said he would like to see a ten-year history of the annual actuarial determined liability and how much of it was unfunded. Ms. Bilyeu responded that information could be provided to the committee.

Ms. Bilyeu then asked Laura Wallace, System Investment Officer, to present the investment report.

C. Investment report on the PERS, Legislators' Retirement and Judicial Retirement Funds.

Ms. Wallace introduced herself and referred committee members to the exhibits found in Tab C of the meeting packet (Exhibit A); she would summarize the status of the PERS', Legislators' and Judicial investment portfolios. She noted that page 170 of Exhibit A summarized the investment objectives for all three investment programs, which were essentially the same. As stated, they were focused on an 8 percent investment return, and the system very aggressively managed risk in the three programs. Ms. Wallace noted that focus was also on transparency for processes and holdings in all of the portfolios.

Moving to page 171 of Exhibit A, Ms. Wallace said some summary investment performance information was provided on the three portfolios. She also indicated she would be providing updated investment performance data; the material in the meeting packet was reconciled as of November, but she now had information through December (first six months of Fiscal Year 2005-06).

Vice Chairman Raggio asked how the returns for FY 2005 and FY 2006 to date would compare to S&P returns for similar periods. Ms. Wallace replied that the S&P 500 comprised approximately 45 percent of the assets in all three funds.

Restating his question, Vice Chairman Raggio asked how the comparable holdings that had been managed through PERS would compare with an investment in an S&P 500 fund. Ms. Wallace said the honest answer would be that it would vary from year to year, but specifically in the year ending 2005, the PERS fund was advantaged by the utilization of some active management in that portfolio. She explained that investments were blended index funds and active management, and it was an advantage to the system in that year. Ms. Wallace noted that a different time period might reverse itself and could sometimes be a detriment.

Vice Chairman Raggio wondered if the cost of management of funds was paying for itself. Ms. Wallace said she understood what Vice Chairman Raggio was saying, adding that the issue had been discussed at the PERS Board meeting the previous week and several times before that. She noted that over the last 20 years, the index position had migrated from a 50 percent allocation to 65 percent in the portfolio for the reasons Vice Chairman Raggio cited.

Vice Chairman Raggio observed the \$22 million cost of investment management fees was obviously a small percentage when considered with the total amount of the fund. Ms. Wallace agreed, adding that larger fees were particularly associated with active equity strategies.

Again referring to page 171 of Exhibit A, Ms. Wallace pointed out that the figures in the right-hand column reflected different inception dates, which should be considered when comparing the numbers.

Continuing, Ms. Wallace explained that pages 172, 173 and 174 of Exhibit A provided a breakdown of the investment performance by individual year for each program. She directed the committee's attention to page 172 and remarked that in looking at the individual years of performance, and knowing that PERS was a very conservative investor, a meaningful amount of volatility as a by-product of being an institutional investor was acceptable, but a great deal of attention was focused on an effort to try to mute as much of the volatility as possible.

The same pattern and risk adjusted ranking for the legislators and judicial assets on page 174; that investment program had not been up and running as long as the other two. That portfolio commenced in a difficult environment.

The *PERS' Investment Strategy* pages detailed the investment strategy and the allocation of the assets. Ms. Wallace noted there were modest differences between the way the PERS fund was invested and the two smaller funds, the Legislators and Judicial, which was purely a function of size. The targeted risk adjusted returns were virtually identical. There was no change in strategy since the last report to the committee.

In conclusion, Ms. Wallace said the focus continued to be foremost on the security of the management of the assets entrusted to the system and the stability in liability and asset management. The system still felt that the 8 percent investment return target was a reasonable one.

Assemblyman Seale asked if the asset allocation included any alternative assets. Ms. Wallace replied the PERS fund included a 10-percent allocation to alternative assets.

D. Update on one-fifth of a year purchase of service for certain education employees.

Dana Bilyeu, Executive Officer, explained the purchase of one-fifth of a year benefit that was provided pursuant to NRS 391.165. She said the benefit was provided to educational employees who had completed one year of employment at a school that had been designated as needs improvement or had at least 65 percent at-risk pupils. Additionally, purchases must be made for any teacher who held an endorsement of mathematics, science, special education or English as a second language and had been employed for one year in the area of endorsement. Members must meet the minimum five years of service under the Retirement Act and not have already purchased five years of service credit.

Attached to the memorandum was a spreadsheet of costs as tracked by the system. Ms. Bilyeu pointed out that PERS started its tracking tool in May of 2005, and the volume of purchases became fairly significant; over 2,000 purchases were made in 2004 and over 6,000 in 2005 under the program. PERS was working with the Department of Education to recapture the purchases made prior to the May tracking tool inception date. The committee would be updated as the information became available. Ms. Bilyeu said she had brought this item to the committee's attention

because in testimony before the money committees, PERS was concerned about the magnitude of the purchase process for this number of individuals and wanted to show there was a fairly significant number of them, as well as the costs associated with them. She said PERS also wanted to update the committee on the internal process changes that were made in order to speed up the purchase service process. PERS accomplished 6,000 or more of these purchase agreements with the existing staff on an overtime basis.

Chairman Arberry asked if Ms. Bilyeu thought the number of purchases would remain stable or if they would increase. She replied she was not the best judge, but it was her impression that the Department of Education believed the number would increase as more schools were moved into the needs improvement category, as well as the areas of endorsement, which tended to be a smaller percentage. The movement of schools to the needs improvement category would be the driving force behind the number of purchases. During the 2005 Legislative Session, the department had indicated the number of purchases would be between 6,000 and 9,000, but Ms. Bilyeu had not received the department's projections for FY 2006-07.

Chairman Arberry asked if the system would need additional positions in the next biennium in the event the purchases increased substantially. Ms. Bilyeu replied that the process had been expedited whereby individual agreements to the members were no longer issued and group agreements to the employers were issued, which resulted in tremendous time savings when processing voluminous purchase agreements. She was not sure additional positions would be needed, but she would consult with her staff as to the implications of a much larger number of purchases going forward.

E. Status report on the Judicial Retirement System and implementation of Senate Bill 438 (2005) regarding participation by justices of the peace and municipal court judges.

Ms. Bilyeu stated that Item IV-E was an update on the status of the Judicial Retirement System (JRS). Current normal cost payments were made monthly to the Judicial Retirement System by the Administrative Office of the Courts on behalf of all Supreme Court justices and district court judges. The normal cost of the program by the actuarial valuation completed in January 2005 was 22.5 percent. The annual actuarial valuation of the judicial retirement system was performed on a calendar year basis. The system was completing data clean-up, and the information would be sent to the actuary to continue the process; as soon as the new actuarial valuation was complete, it would be provided to the committee for review.

Ms. Bilyeu wanted to update the committee on the implementation of Senate Bill 438, which provided the opportunity to participate in the Judicial Retirement System for justices of the peace and municipal court judges on an employer-by-employer basis. The voluntary addition of justices of the peace and municipal court judges did not affect the costs for the state, as costs associated with these judges would be borne by the local government jurisdictions that employed them.

Each local government that elected to cover their judges in the JRS would be valued separately for purposes of determining not only the normal cost of benefits, but also the cost of payment of any unfunded liability that might arise. Transfers would be made for judges opting to move from PERS to the JRS in the same fashion as those transfers for district court judges and Supreme Court justices, which meant that PERS would transfer the assets from PERS to that program at 100 percent funding; there would be no initial unfunded liability associated with that program. It would simply be something that happened as PERS moved through the demographics and the actual accumulation for that program.

Ms. Bilyeu said eight judges were currently opting over; five local government jurisdictions would be covered, but that number was expected to grow over the course of the next year.

F. Update on Assembly Bill 555 (2001) and Senate Bill 439 (2003) concerning critical labor shortage exemptions from PERS' reemployment restrictions.

Ms. Bilyeu referred to page 189 of Exhibit A, which was a review of the history of the reemployment exemption for positions designated as critical labor shortage pursuant to A.B. 555. The usage of the exemption over time was summarized in the memorandum and detailed in the spreadsheet beginning on page 191.

Ms. Bilyeu explained that Assembly Bill 555 of the 2001 Legislative Session provided for an exemption from PERS' normal reemployment provisions designed to aid employers in filling positions of critical labor shortage. The bill evolved out of an interim study conducted by the Retirement System authorized in the 1999 Session and was primarily focused on educational positions, both in K-12 and university positions.

Since PERS was a cost-sharing multiple-employer program, the board recommended legislation that would apply equally to all employers should the employer determine that a position met the definition of critical labor shortage. The criteria to be considered by employers was outlined in the staff memorandum.

Ms. Bilyeu noted that the spreadsheet reflected that as of January 6, 2006, 191 positions had been determined to meet the criteria for designation as critical labor shortage. On Tuesday, January 23, 2006, PERS received certification from the Department of Education for a Washoe County math teacher, so the number for critical labor shortage positions currently stood at 192. Of the 192 positions, 85 percent were related to the educational component of public employees.

Continuing, Ms. Bilyeu explained that Senate Bill 439 of the 2003 Session required that each employer re-designate positions as meeting the criteria for critical labor shortage every two years. PERS had begun the process of requesting those recertifications from the employers and had received certification on positions for UNLV, the Elko County School District and the Keystone Academy.

Vice Chairman Raggio noted that the chart included senior judges and wondered if the senior judge program was included. Ms. Bilyeu replied that under the statute, the Supreme Court was authorized to make designations for the judicial branch, and they had designated both senior Supreme Court justices and senior district court judges as critical labor shortage positions.

Vice Chairman Raggio asked how the program would apply to retired judges; he understood they received a retirement and senior judges were paid from a fund for the senior judge program. He asked if they received an additional retirement under this program.

Ms. Bilyeu replied reemployed Supreme Court and district court judges worked on an hourly basis for the Administrative Office of the Courts, and they had the right to re-enroll and accumulate if they had not met the top portions of the Judicial Retirement System or PERS, depending on which fund they retired from. As they met the threshold for a new year of accumulated service credit, an additional year of benefits would be granted, similar to members of PERS who also had the right to re-enroll if they have not met the caps of the 75 percent or 90 percent, depending on the hire date. In essence, the judges had a right to re-accumulate a second benefit that would be added to their initial benefit. She added that was typical for all re-employed retirees under the current PERS statutes.

Vice Chairman Raggio said he did not realize it applied to the senior judge program; he thought the Legislature had funded a separate plan to provide for contracts for senior judges.

G. Update on Senate Bill 346 (2005) relating to voluntary participation in the Legislators' Retirement System.

Ms. Bilyeu said that Senate Bill 346 provided an opportunity to all currently participating legislators and those elected in the future to participate (or not) in the Legislators' Retirement System (LRS). In support of this choice, PERS' staff provided information to each legislator to assist them in evaluating whether to remain in the LRS or to seek a refund of personal contributions. The memorandum in the meeting packet (page 197, Exhibit A) described the information provided to each legislator, depending on their length of service.

To date, six legislators had contacted the system to seek refunds of personal contributions. PERS provided copies of the option forms to the Director of the Legislative Counsel Bureau to complete the requirements of the statute. The total amount of refunds paid or pending at this time was \$22,075.20.

Ms. Bilyeu remarked that moving toward the election in November, PERS would work with the LCB Director's office to provide relevant information to the newly elected members concerning the benefit available to them and to aid the legislators in making their choice to participate.

Chairman Arberry asked if payment was made in one lump sum; Ms. Bilyeu replied that was correct. Upon the legislator's request, the system would pay the personal contributions that were paid out of the legislative paychecks earned during sessions.

Chairman Arberry noted that the system indicated payments would not adversely affect overall funding. Ms. Bilyeu replied that because of the small amounts of the refunds and the actuarially accrued payments that were coming in from the Legislative Counsel Bureau, there may actually be an increase in the funding ratio of this particular program after the next valuation.

Vice Chairman Raggio asked how many former legislators were still receiving augmented benefits from the increased pension that was repealed, but they were still eligible because they had retired earlier. Ms. Bilyeu replied she thought there were two receiving the higher pension.

V. PUBLIC COMMENT

Sergeant Bob Roshack, Las Vegas Metropolitan Police Department, addressed the committee regarding A.B. 286. He said the Las Vegas Police Department had received a legal opinion indicating that it was exempt from the requirements of A.B. 286, and that legal opinion had been provided to the Public Employees' Benefits Program and the State Attorney General's Office. Mr. Roshack added that the department also had a self-funded plan for medical insurance for retirees.

Chairman Arberry asked who provided the opinion; Mr. Roshack did not have the name of the law firm that issued the opinion, but he would provide the information to the Fiscal Division staff.

Senator Beers asked if the department had a fund set up to pay for the health plan for retirees. Mr. Roshack replied each participant paid \$50 a month into the self-insured plan, and once participants retired, they received approximately \$300 a month from the trust. The plan was put in place approximately 10 years ago.

Senator Beers asked why A.B. 286 was an issue for the department. Mark Stevens, Assembly Fiscal Analyst, replied it was probably an issue because there were Las Vegas Metro employees in the PEBP plan, and PEBP was incurring costs for those employees. Assembly Bill 286 provided that local governments would be responsible for paying a subsidy for those retirees that entered the PEBP plan in the same manner that the state subsidized its retirees.

Senator Beers said it appeared that Metro had a different method of subsidizing their retirees rather than the described method. Mr. Stevens believed what was being said was that Metro provided for their retirees within their own group insurance plan. He asked Mr. Roshack if everyone was in PEBP or if the department had different plans for which a retiree could receive group insurance. Mr. Roshack replied the department had the Health-Welfare Trust, the civilian union had its own retiree plan, and there were certain LVMPD retirees in PEBP. However, the funding for the self-funded plan came from each individual employee contributing to the fund.

Mr. Stevens remarked that the employees had the choice of staying in their own health insurance plan or going to PEBP, and since PEBP indicated there was an accounts receivable, a certain number of LVMPD retirees had chosen the PEBP plan.

Senator Beers observed that it seemed the Metro retirees were getting their subsidy paid directly to them. He asked if PEBP was charging a subsidized rate for those retirees rather than a full rate. Mr. Stevens replied the local entity paid PEBP the full rate, but would be responsible for subsidizing to the extent that the state subsidized its retirees to lower the cost.

Senator Beers sought further clarification: There was a premium for retirees, and the state retirees were charged less; the state paid a portion and, in some cases, the entire premium. The non-state retirees had a self-funded plan.

Mr. Stevens clarified that not every local entity offered their retirees a group insurance benefit, which was the sole reason that a local government retiree was given the choice to go into the PEBP plan. In a number of instances, the employee did not have an option for health insurance once he retired.

Assemblywoman Koivisto recalled that in the 2005 Legislative Session, a bill had been requested by firefighters concerning this same issue; she did not know what became of that request.

Assemblyman Seale asked if the police officers were being insured twice – once by Metro and once by PEBP. Mr. Roshack replied it was his understanding that was not the case; they either stayed with Metro or did not accept it and joined PEBP.

There was no further public testimony.

VI. ADJOURNMENT

There being no further testimony to come before the committee, Chairman Arberry adjourned the meeting at 5:05 p.m.

Respectfully submitted,

Sherie Silva, Transcribing Secretary

APPROVED:

Chairman Morse Arberry Jr.

Date: _____