

Teacher Health Care and Pensions, Act 179

PROBLEM STATEMENT

The Teachers' Retirement Funding Dilemma:

The balance of healthcare premiums for retired teachers has been paid from the teachers' pension fund after other current sources of payment are deducted. In FY2014, that amount for Vermont's 7,700 retired teachers (of whom about 2/3 make use of the benefit) is about \$22 million, which will reduce the \$1.55 billion pension fund by nearly 1.4% (this cost is net of a 20% teacher co-pay for the benefit). As of June 30, the funded ratio (assets divided by liabilities) of the teachers' pension was 60.6%; under the present system, this ratio is expected to continue to deteriorate by at least a percentage point each year.

Just as with an individual home mortgage, there is an interest cost associated with borrowing to cover healthcare costs. Since pension funds are expected to earn interest in the range of 7.75%, this borrowing, "or retrospective" funding mechanism, is costing the taxpayer significant dollars. For every \$1 dollar in premium not paid today, it will cost the taxpayer \$3 over time.

A continued decline in the funded ratio could negatively impact Vermont's bond ratings, driving up the State's borrowing costs. As more teachers retire, and as health care costs increase, the teachers' pension fund will be further strained, causing the annual required contribution (ARC), currently \$73 million, to rise at an accelerating rate.

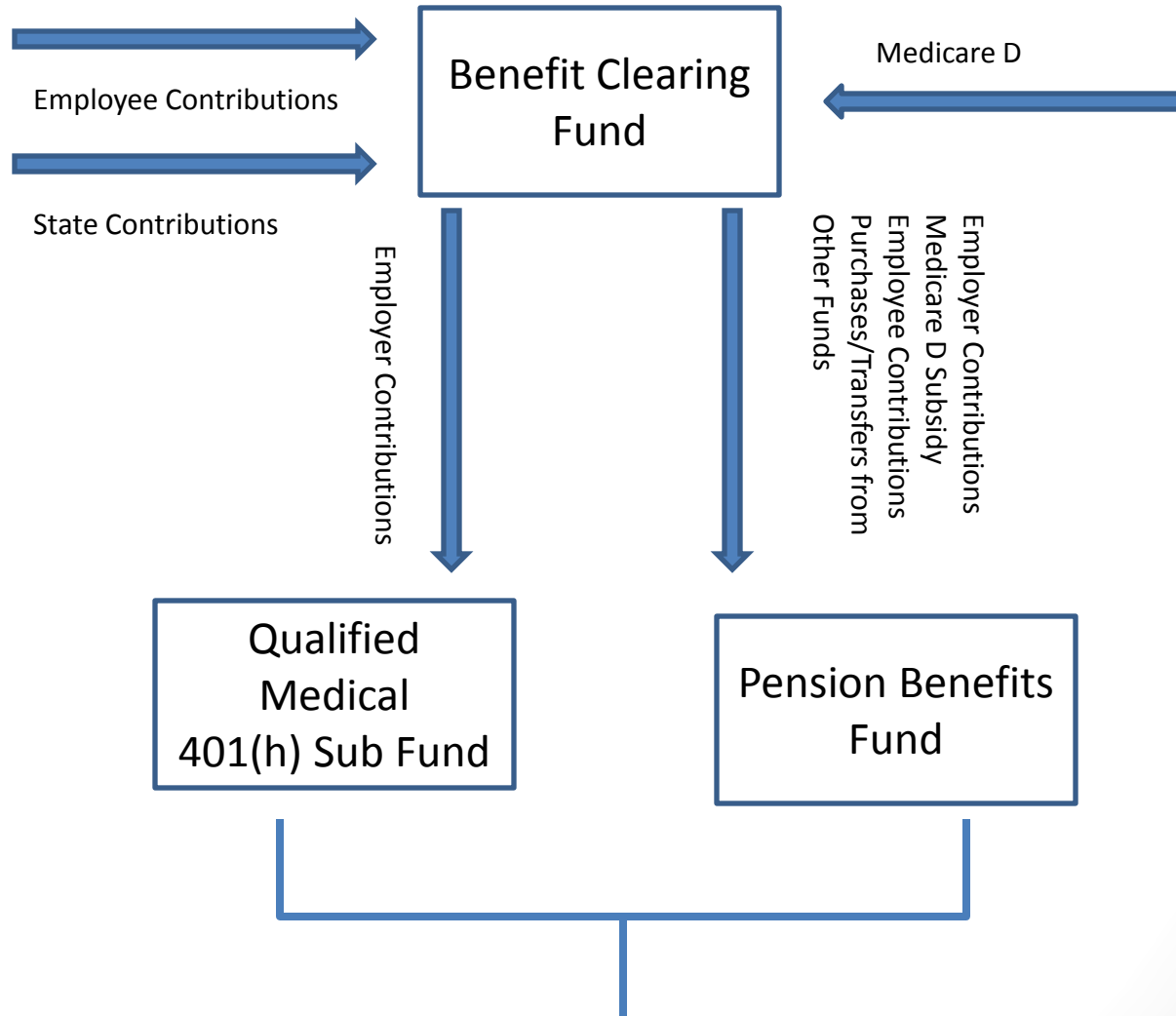
TEACHERS RETIREMENT FUND

Since FY 2008, when it was funded at 80.9% of actuarial value, the Teachers Retirement Fund's funding level has experienced decline:

2009	65.4%
2010	66.5%
2011	63.8%
2012	61.6%
2013.	60.5%
2014	59.9%

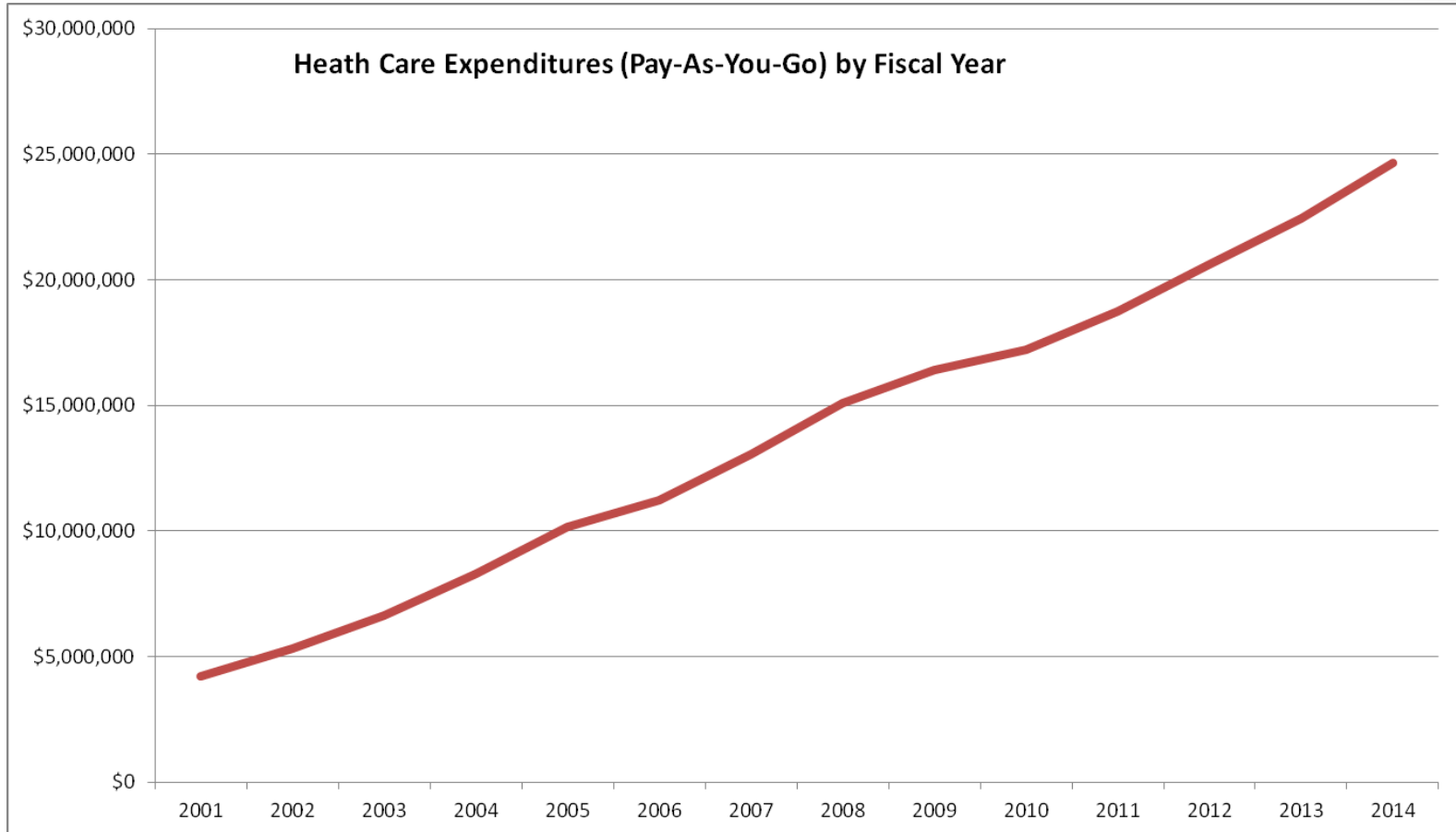
In part, this decline is due to the retired teacher health care costs being paid from the Teachers Retirement Fund (without a dedicated source of revenue for these costs).

Pension Fund Structure Up to FY 2015



Both Comprise the Pension Fund

Health Care Expenses Are Rising



Health Care Expenses													
2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
4,194,215	5,299,600	6,634,738	8,279,332	10,167,601	11,233,854	13,040,783	15,081,847	16,421,176	17,203,669	18,749,675	20,620,144	22,459,219	24,640,986

THE FUNDING NEEDED

Two key steps are necessary to address this problem:

1. Funding Source. The balance of these health care costs needs to be separately funded rather than absorbed by retirement funding. The State and the Vermont-NEA have worked to address some of this problem through a \$4.75 million existing General Fund appropriation and \$4mm in annual Medicare Part D savings through structural changes to the fund agreed to by the Vermont-NEA. To adequately meet the remaining funding need another \$20 million should be provided in 2015, growing at 5% per year.

2. Separate Accounting. The retired teachers' health benefit obligation needs to be segregated out of the teacher's retirement fund into its own trust fund with ongoing funding sources. This would allow the retirement fund with its full actuarial funding to recover to a more acceptable funding level.

Impact of Enacted Benefit Changes to 2010 OPEB Valuation

- Actual impact on unfunded liability exceeded original estimates, in part in combination with other lower health care inflation rates:
- Per the consulting actuary, The decrease in liability is attributable to the following factors:
 - an increase in plan premiums smaller than expected;
 - removal of assumed age-morbidity factors;
 - changes to eligibility and cost-sharing plan provisions effective July 1, 2010, including associated changes in assumptions and attribution method.
- Unfunded liability reduced in **2010 from \$872 million to \$704 million.**

Teacher Unfunded OPEB Liability

Unfunded Teacher OPEB Liability

6/30/2014 \$777 Million

6/30/2013 \$713 Million

6/30/2012 \$827 Million

6/30/2011 \$780 million

6/30/2010 \$704 million

6/30/2009 \$872 million



Implementation of Employer Group Waiver Plan (EGWP)



Implemented Savings Initiatives including Tiered Eligibility Structure

- Liability Side has been addressed with significant initiatives but lack of a funding policy for health care continued to create upward pressures through 2014.

Factors Impacting Unfunded Liability:

- Expected increases due to the passage of time (and lack of funding) although offset in 2013 by EGWP initiative negotiated with NEA
- Updates to demographic assumptions as recommended by the Experience Study of the State Teacher's Retirement System of Vermont, presented to the Board on March 23, 2011
- 2009-2010- Negotiated benefit changes with NEA

Example Amortization of \$20 million of Retiree Healthcare Costs

Fiscal Year-End Date	Unfunded Liability Balance	"Select and Ultimate" Discount Rate	Interest on Unfunded Liability	Amortization Increasing at 5.00%
6/30/2012	20,000,000	6.25%	1,250,000	1,150,174
6/30/2013	20,099,826	6.75%	1,356,738	1,207,682
6/30/2014	20,248,882	7.00%	1,417,422	1,268,067
6/30/2015	20,398,237	7.50%	1,529,868	1,331,470
6/30/2016	20,596,635	7.75%	1,596,239	1,398,043
6/30/2017	20,794,831	8.25%	1,715,574	1,467,945
6/30/2018	21,042,459	8.25%	1,736,003	1,541,343
6/30/2019	21,237,120	8.25%	1,752,062	1,618,410
6/30/2020	21,370,772	8.50%	1,816,516	1,699,330
6/30/2021	21,487,957	8.50%	1,826,476	1,784,297
6/30/2022	21,530,137	8.50%	1,830,062	1,873,512
6/30/2023	21,486,686	8.50%	1,826,368	1,967,187
6/30/2024	21,345,867	8.50%	1,814,399	2,065,547
6/30/2025	21,094,719	8.50%	1,793,051	2,168,824
6/30/2026	20,718,947	8.50%	1,761,110	2,277,265
6/30/2027	20,202,792	8.75%	1,767,744	2,391,129
6/30/2028	19,579,408	9.00%	1,762,147	2,510,685
6/30/2029	18,830,869	9.00%	1,694,778	2,636,219
6/30/2030	17,889,428	9.00%	1,610,049	2,768,030
6/30/2031	16,731,447	9.00%	1,505,830	2,906,432
6/30/2032	15,330,845	9.00%	1,379,776	3,051,753
6/30/2033	13,658,868	9.00%	1,229,298	3,204,341
6/30/2034	11,683,825	9.00%	1,051,544	3,364,558
6/30/2035	9,370,812	9.00%	843,373	3,532,786
6/30/2036	6,681,399	9.00%	601,326	3,709,425
6/30/2037	3,573,299	9.00%	321,597	3,894,896
6/30/2038	0	9.00%	0	0

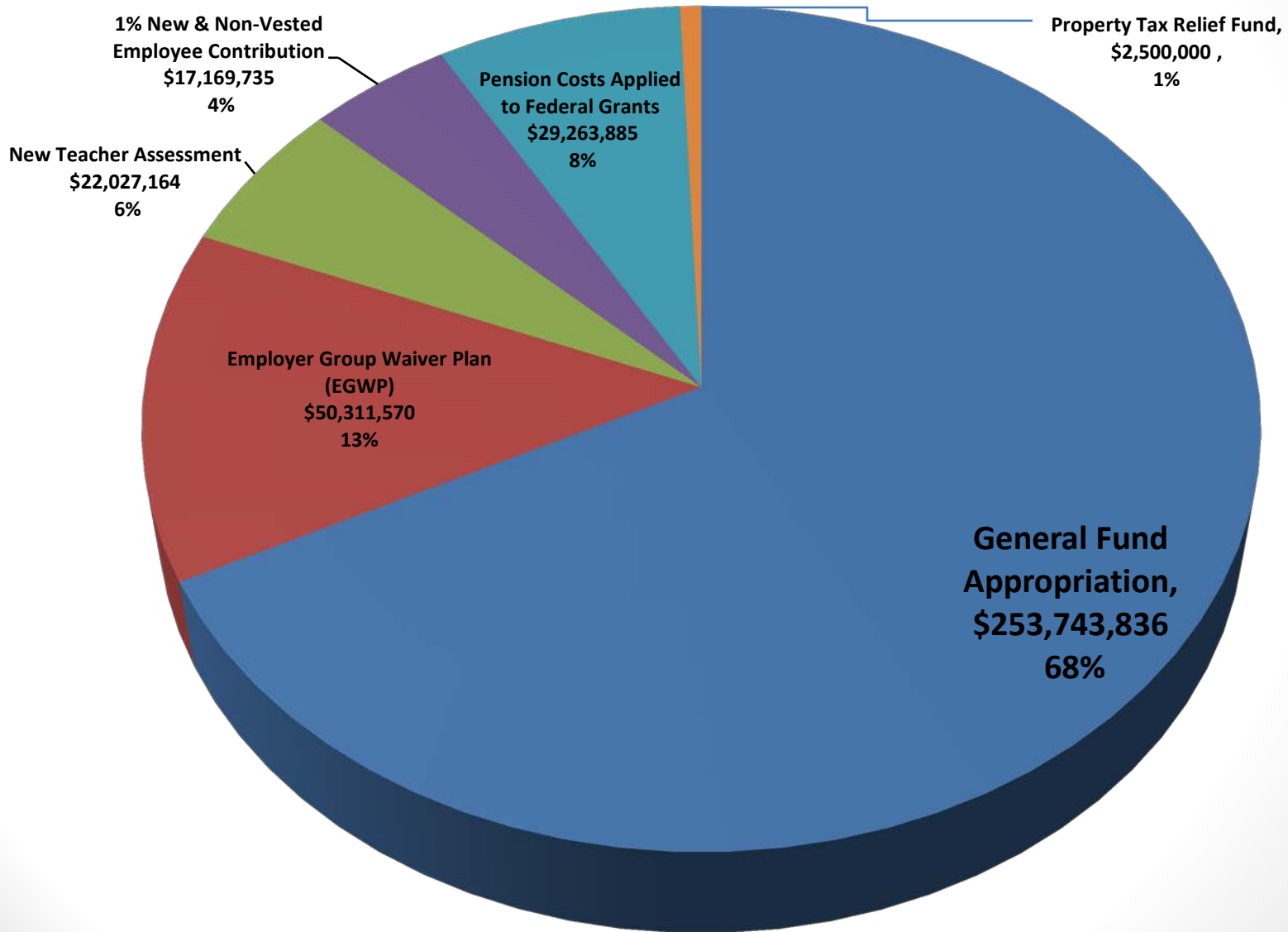
Total Amortization Payments:

58,789,350

Fundamental Changes to Health Care Funding Effective 7/1/2014

- The State has established and funded a separate trust to account for the assets and liabilities of the retiree medical benefit plan.
- Annual contributions to the Retiree Medical Plan are be separately identified in the State budget and not commingled with Retirement Plan contributions.
- A series of funding sources were put in place, replacing the “retroactive” funding approach.
- Will save \$480 million in interest through 2038.

Sources of Funds over Next 10 Years



Retired Teachers Health and Medical Benefits Fund

	<u>Annual Increase</u>	<u>FY 2015</u>	<u>FY 2016</u>	<u>FY 2017</u>	<u>FY 2018</u>	<u>FY 2019</u>	<u>FY 2020</u>	<u>FY 2021</u>	<u>FY 2022</u>	<u>FY 2023</u>	<u>FY 2024</u>	<u>10-Year Totals</u>
Fund Starting Balance:		\$0	\$2,007	\$26,638	\$6,753	\$5,347	\$614,764	\$91,547	\$38,461	\$36,347	\$25,900	
Annual Healthcare Cost:	5.0%	(28,600,000)	(30,030,000)	(31,531,500)	(33,108,075)	(34,763,479)	(36,501,653)	(38,326,735)	(40,243,072)	(42,255,226)	(44,367,987)	(359,727,727)
<u>1. Existing Sources</u>												
Current General Fund Appropriation:	3.5%	4,750,000	4,916,250	5,088,319	5,266,410	5,450,734	5,641,510	5,838,963	6,043,326	6,254,843	6,473,762	55,724,118
Employer Group Waiver Plan (EGWP):	5.0%	4,000,000	4,200,000	4,410,000	4,630,500	4,862,025	5,105,126	5,360,383	5,628,402	5,909,822	6,205,313	50,311,570
<u>2. New Sources</u>												
New General Fund Appropriation:	3.5%	2,500,000	5,000,000	7,500,000	10,000,000	10,350,000	10,712,250	11,087,179	11,475,230	11,876,863	12,292,553	92,794,075
Reduction to Pension Annual Required Contribution:		0	2,660,218	4,273,594	6,108,212	8,192,984	10,561,392	13,252,542	16,312,528	19,795,977	23,768,196	104,925,643
\$1,072 Employer Assessment Per New Teacher:		0	375,200	787,920	1,240,974	1,737,364	2,280,290	2,873,165	3,519,627	4,223,553	4,989,072	22,027,164
1% New & Non-Vested Employee Contribution:		1,002,007	1,152,963	1,291,783	1,439,373	1,596,165	1,762,609	1,939,176	2,126,357	2,324,666	2,534,638	17,169,735
Pension & Health Costs Applied to Federal Grants:	2.0%	0	3,000,000	3,060,000	3,121,200	3,183,624	3,247,296	3,312,242	3,378,487	3,446,057	3,514,978	29,263,885
Legislature's Additional Contribution:	3.5%	300,000										300,000
Property Tax Relief Fund:		2,500,000										2,500,000
<u>3. Interfund Borrowing</u>												
Borrowing from State's Cash:		13,550,000	8,750,000	5,100,000	1,300,000							28,700,000
Repayment of Interest:	2.0%						(2,332,038)	(540,000)	(443,000)	(287,000)	(61,000)	(3,663,038)
Repayment of Principal:							(1,000,000)	(4,850,000)	(7,800,000)	(11,300,000)	(3,750,000)	(28,700,000)
Fund Ending Balance:		\$2,007	\$26,638	\$6,753	\$5,347	\$614,764	\$91,547	\$38,461	\$36,347	\$25,900	\$11,625,426	\$11,625,426