A Path towards Pre-Funding

*The History of the **Retired Teacher's Health and Medical Benefit***
Funding Plan

Vermont State Treasurer's Office
January 31st , 2020

A Deal is a Deal…

…and we are requesting that the current deal be maintained

- <u>**Our Request**</u>
  - Restore dollars to requested appropriations for the Retired Teachers Health & Medical Benefit Fund (RTHMB)
  - Create a policy in statute for pre-funding.
    - Our projections assume only a 2-3% increase in GF Appropriations after 2025 to stay within inflation.
  - Revise statute to increase investment opportunities for Treasurer
    - Trust Investment Account (TIA)
    - Pension Investment – Include in VPIC (same request for VSERS Other Post Employment Benefits) (OPEB

- We need to show discipline in funding. We do not want to go down the path we took with Underfunding the Pensions in the 1990's and early 2000's.

- Need a surplus to protect prefunding in the first couple of years.
  - Compounding Interest argues for early investment and against waiting.
  - Protects against volatility in markets (e.g. recession).

- The Treasurer's Office will be evaluating pre-funding opportunities for VSERS OPEB in the upcoming months.

History of Addressing Funding for Health Care

- Most of post retirement efforts have been concentrated on reducing liabilities
  - Tiered health care structure
  - EGWP
  - We are now at stage to begin prefunding of VSTRS and potentially VSERS down the road

- VSERS- Benefit structure changes effective for new employees after July 1, 2008

- VSTRS-Benefit changes to a tiered structure effective July 1, 2010

- Incremental steps taken
  - Health Care changes requiring additional appropriations from employees and teachers with less service
  - Historical "putting on the credit card" for VSTRS
    - Partially addressed in 2012
    - Larger plan developed in2014
    - Has potential to create prefunding **if we maintain fiscal discipline**

Pre-Funding is the Key to Budget Stability and Saving Taxpayers Money

Which requires restoring the $5,973,051 to the Appropriations for the RTHMB

- Both Moody's and S&P noted significant OPEB liabilities as part of demographic challenges as areas of concern in their credit ratings

- **There is opportunity to lower our liabilities by almost 45% (~$474M) on VSTRS.**

- We expect to reach pre-funded status by 2025 with current plan and commitment in statute, and with continued support, fully funding by 2048.

Pay-Go

UAAL for FYE June 30, 2021 at 3.50%	
Actuarial accrued liability	$1,069,220,408
Estimated assets	(323,013)
Estimated UAAL	$1,068,897,395
ADC for FYE June 30, 2021 at 3.50%	
Normal cost	$27,189,374
Amortization of the UAAL	40,722,830
Total Actuarially Determined Contribution	$67,912,204

Pre-Funded

UAAL for FYE June 30, 2021 at 7.50%	
Actuarial accrued liability	$594,912,834
Estimated assets	(335,497)
Estimated UAAL	$594,577,337
ADC for FYE June 30, 2021 at 7.50%	
Normal cost	$10,707,251
Amortization of the UAAL	35,657,941
Total Actuarially Determined Contribution	$46,365,192

SAVINGS

- UAL Decreases $474M once we reach pre-funding.
- Normal Cost of benefits is $11M/year

What is Pre-funding and how do we achieve pre-funded Status?

Retrospective Funding → Pay-Go → Pre-Funded → Fully Funded

- GASB 74/75 required the separate accounting of OPEB costs from Pension Costs.
  - Pre-2014 Healthcare Costs were paid using pension assets, treated as an actuarial loss, and reducing the funded percentage.
  - As we are only paying the current years bills, we are in Pay-Go

- Pre-Funded Status is for plans with monies invested and moving towards full funding. In order to meet Pre-Funded Status, you must have the following:
  - Large enough Fund Balance to pass crossover analysis
  - Commitment in Statute to Fund above Pay-Go

- Crossover Analysis
  - Reviews ability of investments and future contributions to pay future benefits
  - Performed by actuaries to ensure that fund will **not** be emptied before all benefits are paid.

Pre-Funded Status allows us to count on investment returns and future contributions to fund benefits

But getting there wasn't easy…

Teacher Health Care Benefit Changes Effective 2010

- For new hires and those with less than 10 years of service…
  - 1 to 14 years: No subsidized coverage
  - 15 years: 60% Single
  - 20 years: 70% Single
  - 25 years: 80% Single or spousal

- Current actives with more than 10 years of service…
  - 80% single coverage - same as now
  - 25 years: 80% single or spousal coverage
  - However:
    - Those with more than 30 years of service will have to work another 5 years to be eligible for spousal coverage.
    - Those with 25 to 30 years of service will have to work a total of 35 years.
    - Those with 15 to 24 years of service will have to work 10 more years.
    - Those with 10 to 15 year of service will be eligible upon 25 years of service.

Teacher Funding Issue- Pre 2014

The lack of funding for teachers health care liabilities is the ***single greatest threat*** to the stability of the teacher pension fund.

"Unlike the state system where the "pay-as-you-go" portion is budgeted and funded in a separate OPEB Trust fund, the health care expenses for VSTRS are paid out of the pension fund and are treated as an actuarial loss to the system, creating additional financial stresses on the pension system…Health care costs over the last decade or more have risen at a much higher rate than the rate of inflation, and while some stabilization of that trend is expected, costs are projected by our actuaries to continue to exceed CPI. The situation for the teachers' health care payments is reaching a critical phase….

The Retirement Commission unanimously voted to include a recommendation to the Legislature to develop, without delay, a structural plan and process to fund the OPEB obligations and set money aside in a material way in a separate, independent funding mechanism."

–Source: "Report of the Commission on the Design and Funding of Retirement and Retiree Health Benefits Plans for State Employees and Teachers", December 2009, p.37.

Example $20 million of health care premium costs put on the credit card in FY2012 will cost the taxpayers $58.8 million.

Fundamental Changes to VSTRS 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.

Projected to save $480 million in interest through 2038

A Path towards Pre-Funding was established in 2014

- Collaborative effort by the prior Administration, the Treasurer’s Office, VSTRS Trustees, the NEA, JFO, and both the Senate and House.
- Also included participation by the VLCT, School Board Association, Vermont Superintendents Association, and others.
- Has a combined effort of utilizing federal dollars, increased contributions by teachers, local school contributions and explicit general fund appropriations.
- Long Term View requiring fiscal discipline.

Retired Teachers Health and Medical Benefits Fund

	Annual Increase	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024	10-Year Totals
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)
1. Existing Sources												
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**
2. New Sources												
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**
3. Interfund Borrowing												
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**

Key:

Appropriation funding sources hardcoded into plan in 2015

Appropriation that will grow over time based on new contributions that relieve appropriation dollars in pension, then applied to OPEB

Federal or local resources make up balance in years 2016-2024

FY2015 startup- Loan to be repaid, one time contribution and $ from property tax relief fund

This Path is based on contributions from State & Federal funds, Schools, and Teachers

Through 2018

- Premiums grew faster than expected in early years of plan but were offset by:
  - Local contributions have continued at higher levels than originally planned (although New Teacher Assessment will sunset in 2023 and further action to extend will be needed)
  - Federal monies (Employer Group Waiver Plan or EGWP) have increased at higher rates than anticipated.
  - Federal grant money higher than anticipated

- The State continued to fund its share of the appropriations <u>without an increase over the initial plan</u> due to contributions from other sources

And that Plan has been adhered to…

- FY 19 – During Budget Adjustment, $22.2M was granted in additional General Fund appropriations to retire the interfund loan.
  - As consideration for earlier loan repayment - FY20 general fund appropriations were reduced and the FY 21 general fund appropriations were to be restored at a slightly lower amount (reflected in the OST request)
- There is a significant cost to removing dollars from the Plan

How much will the $5,793,051 be worth if we restore it?

Shortfall	Rate	Projected Value if invested	Target Date	
5,793,051	7.50%	7,736,441	at 2025	Pre-Funded
		40,825,911	at 2048	Fully Funded
5,793,051	6.50%	7,452,565	at 2025	Pre-Funded
		31,720,992	at 2048	Fully Funded

The budgeted shortfall of $5,973,051 will cost the state millions in interest savings

One-time money was used to pay off the Loan, and move closer to pre-funded status

Presented by the Treasurer and Deputy of Administration to House Appropriations on 1/23/19

* - This chart presented by the administration was a summary of the spreadsheet shared 1/23/20 developed by the OST.

Current Plan - Teacher's OPEB Fund

1	OPEB Balance FY19	($26.4) million
2	FY19 GF Appropriation to pay down loan	$ 4.2 million
3	FY19 Loan Balance	($22.2) million
4	FY20 Appropriation request to paydown loan	$6.3 million
5	FY20 Projected Loan Balance	($16.2) million
6	FY21 - FY25* Estimated Appropriations	$ 239 million
7	By FY2025, fund balance grows to	$57 million

Plan* approved in BAA 2019

Alternative Plan - Teacher's OPEB Fund

1	OPEB Balance FY19	($26.4) million	
2	FY19 GF normal appropriation to pay down loan and FY19 One Time Paydown	$ 4.2 million $22.2 million	
3	FY19 Loan and Fund Balance	$0	
4	FY20 Appropriation to Prefund OPEB	$2.4 million	*3.8 million savings
5	FY20 Projected Balance	2.4 million	
6	FY21-FY25* Estimated Appropriations	$234 million	$5 million est. savings
7	FY 2025 Balance	$75 million	$18 million more prefunding

Funding was decreased in FY20, to be resumed in FY21

* **FY21 - FY25 appropriations will be used to pay yearly premiums to VEHI and contribute to the pre-funding balance in the fund.**

While ensuring that the plan would be maintained going forward.

And we should not lose that momentum

- Pre-Funded Status will save $474M off our Balance Sheet and send the right message to rating agencies.
  - To achieve this we need to maintain the plan, and create a commitment in statute to fund above the Pay-Go

- Continuing to Fund along the plan will allow our plan assets to grow and meet our funding targets by 2048 (end of amortization period).
  - Compounding interest adds up quickly, funding the $5.9M now, will allow it to grow to $7.7M in 2025, and $40.8M in 2048

- The earlier plan assets are accumulated, the more time they have to earn interest, and subsidize benefit payments in the future.
  - Once fully funded, only the normal cost is paid (estimated at $11M in 2021 if pre-funded).

- The State needs to maintain its promise in proposal, as Federal, School, and Teacher dollars have kept pace to the funding plan.

By maintaining the current plan, we maximize savings to Vermonters while keeping our promises to Teachers