Pension Task Force

Overview of Final Recommendations

House Committee on Appropriations

Chris Rupe, Joint Fiscal Office

April 6, 2022

Overview

- Pension Task Force charged with developing recommendations to reduce ADEC and unfunded liabilities by 25%-100% of the YOY growth from FY2021-2022.
- Recommendations unanimously agreed to on 1/10/22.[Link to Report]
- Recommendations included in [S.286].
  - Work from the "as passed by Senate" version – not from the "as introduced" version!
- Recommendations contain a combination of:
  - Employee contribution increases
  - Benefit changes
  - Commitments of additional state funding to pay down liabilities
  - Prefund OPEB
- Much of the savings from pension changes/higher employee contributions is redirected to further shoring up long-term retirement liabilities.
- Combined, the recommendations would be expected to reduce the state's long term unfunded retirement liabilities by approx. **$2 billion.**

Fiscal Targets per Act 75		
	25% of YOY FY21-FY22 Increase	**100% of YOY FY21-FY22 Increase**
VSERS - UAAL	$56.3 million	$225.0 million
VSERS - ADEC	$9.0 million	$36.1 million
VSTRS - UAAL	$94.7 million	$378.8 million
VSTRS - ADEC	$16.1 million	$64.1 million

Note: All fiscal estimates are preliminary and may fluctuate due to additional actuarial analysis, timing, or gains/losses from other factors.

JFO

VSERS Recommendations

- No changes to currently retired or terminated vested members.
- Higher employee contribution rates phased in over 5 years
- Changes to COLA and other benefits
- State makes $75 million one-time payment from $150 million in reserve.
- State commits to an ADEC “plus” payment beginning in FY2024, growing to $15 million in FY2026 and remaining at that level until fund reaches 90% funded.
- Prefund OPEB
- Future recommendations on DOC benefits and longevity incentives

JFO

VSERS Proposed Contribution Rates

- Beginning in FY 2023, increase the contribution rates for all active members:
- Group C: 0.5%/year over 3 years (from 8.53% to 10.03%)
- Groups D and F (currently 6.65%):
  - No change for members with base salaries below the 25th percentile.
  - 0.5 percent per year for 3 fiscal years, for members with base salaries between the 25th and up to the 50th percentile.
  - 0.5 percent per year for 4 fiscal years for members with base salaries above the 50th percentile and up to the 75th percentile.
  - 0.5 percent per year for 5 fiscal years for members with base salaries above the 75th percentile.

VSERS Preliminary Estimates of Additional Revenue from Contribution Changes ($ millions)				
	FY2023	**FY2024**	**FY2025**	**Comments**
Group C Employee Contribution Increases	0.2	0.4	0.6	Additional revenue offsets employer normal cost expenses (a component of the ADEC).
Group D Employee Contribution Increases	0.1	0.1	0.1	Not yet actuarially estimated. Impact likely to be de minimis due to small size of group.
Group F Employee Contribution Increases	2.5	5.3	8.4	Contributions expected to yield $13.3 million of revenue by full phase-in (FY2027).

Estimates are preliminary and may fluctuate due to additional actuarial analysis, timing, or gains/losses from other factors.

Group F:
25th percentile: $50,000
50th percentile: $62,000
75th percentile: $75,000

Higher employee contributions offset normal cost otherwise paid through the ADEC.

VSERS Proposed COLA and Benefit Changes

For Groups C and F:

- Beginning July 1, 2022, modify the COLA structure by:
  - Amending the minimum and maximum amounts of any increases/decreases used to determine the net percentage change in the CPI from the current 1% minimum/5% maximum to 4% maximum.
  - Requiring a member to receive a retirement benefit for at least 24 months of prior to receiving a COLA, an increase from the current 12-month requirement.
  - Actives who are eligible for normal (unreduced) retirement on or before 6/30/2022 are exempt from the changes above.

For Group C:

- Increase <u>mandatory</u> retirement age from 55 to 57.
- Increase max benefit cap by 1.5% for each year worked beyond reaching the later of age 50 or 20 years of service, applied prospectively to service actually worked after July 1, 2022.

For Group D:

- For all active members <u>except</u> those with 5+ years of service and are either within 5 years of age 62 or have 15+ years of service:
  - Amend AFC from final salary to average of 2 final years.
  - Beginning in FY2023, reduce max benefit from 100% of final salary to 80% of AFC.
- For any judge appointed/elected on or after 7/1/22:
  - Raise retirement age from 62 to 65
  - COLA (at 100% of CPI) on first $75,000 of retirement benefit, COLA at 50% of CPI above $75,000.
  - Must receive a retirement benefit for at least 24 months to receive COLA.

JFO

VSERS Proposed COLA and Benefit Changes

The proposed VSERS pension changes listed to the right could save approximately $8.8 million in ADEC costs (across all funds), and reduce unfunded liabilities by approx. $58.4 million.

VSERS Preliminary Estimates of Fiscal Impacts of Plan Changes ($ millions)				
Plan Change	**ADEC**	**Normal Cost**	**Unfunded Liability**	**Comments**
Group C COLA after 24+ months of retirement, plus 1.5% Max Benefit Increase	-3.3	-1.2	-22.0	JFO estimate based on actuarial estimates from Segal. Numbers reflect combined impact without exemptions and may change in combination with other changes.
Group C COLA CPI formula 0% min, 4% max				Fiscal impact not yet estimated but will result in modest actuarial savings.
Group D All proposed changes	-0.1*	-0.1*	-1.0*	*Preliminary JFO estimate pending future actuarial analysis. Impact likely de minimis due to small size of group.
Group F COLA CPI formula 0% min, 4% max, plus COLA after 24+ months of retirement	-5.4	-2.1	-35.4	Actuarial estimates did not exclude actives who are eligible for normal retirement, and therefore may be slightly overstated.

Estimates are preliminary and may fluctuate due to additional actuarial analysis, timing, or gains/losses from other factors.

JFO

VSERS Proposed Additional Employer Contributions

- Make a one-time payment in FY2022 of $75 million (50% of the $150 million currently in reserve in the General Fund).
- Will result in ADEC savings 2 years after the payment (approx. $7.3 million in FY2024 that grows in future years).
- Beginning in FY2024, make an ADEC "plus" payment toward the unfunded liability that ramps up to $15 million by FY2026 and remains at that level until the fund is 90% funded.
  - Effectively redirecting future ADEC savings from the one-time funding in FY2022 toward additional pay down of unfunded liability.
- Reconfigure the year-end General Fund surplus construct to dedicate 25% to the VSERS pension.

VSERS Preliminary Estimates of Fiscal Impacts of Plan Changes ($ millions)				
Plan Change	**ADEC**	**Normal Cost**	**Unfunded Liability**	**Comments**
$75 million one-time payment	-7.3 (FY24)	n/a	-75.0	Impact of funds will reduce ADEC beginning 2 years following payment. Actual savings likely to vary slightly from actuarial estimate provided due to timing.
ADEC "Plus" payments and 25% of General Fund surplus	varies			Fiscal impact not yet actuarially estimated but will result in future ADEC and UAL savings. Impact of General Fund surplus will vary based on timing and magnitude of contributions.

Estimates are preliminary and may fluctuate due to additional actuarial analysis, timing, or gains/losses from other factors.

JFO

VSERS OPEB Proposal

- Build upon the $52.4 million one-time appropriation from the FY2021 year-end General Fund surplus to begin prefunding.
- Enact a prefunding schedule into statute (ADEC).
- Prefunding adds costs of approx. $22.2 million - $24.3 million from FY23 to FY26.

		Onetime $s FY22	FY23	FY24	FY25	FY26
	State Employee Retiree Healthcare Fund	**52.4**				
baseline	GF - current base paygo amount of funding		17.8	18.3	18.9	19.4
baseline	TF/SFs/FF current base paygo amount of funding		24.6	25.3	26.1	26.8
New State$s	Retirement HC for Active State Employees -Normal Cost -All Fds		**22.2**	**22.9**	**23.6**	**24.3**
	Total Retiree Healthcare Fund - with Prefunding		**64.6**	**66.5**	**68.5**	**70.6**
	Unfunded Healthcare Liability current paygo		*1,664.2*			
	Unfunded Healthcare Liability with prefunding		*772.9*			
	Reduction in Unfunded Liability on the state balance sheets		*(891.3)*			

JFO

Estimates are preliminary and may fluctuate due to additional actuarial analysis, timing, or gains/losses from other factors.

VSERS Additional Recommendations

- By April 15th, the Treasurer and VSERS Board of Trustees shall develop recommendations to the Legislature:
    - Creating a new pension benefit group (Group “G”) for Department of Corrections employees that is actuarially neutral to the pension system and results in no additional employer pension costs.
    - A longevity incentive that encourages Group F members who are eligible for a normal (unreduced) retirement to continue working past their retirement date, provided that the incentive is designed to result in actuarial savings to the pension system and reduce employer pension expenses.

VSTRS Recommendations

- No changes to currently retired or terminated vested members.
- Higher employee contribution rates phased in over 3 years in a progressive/marginal structure.
- Changes to COLA
- State makes $125 million one-time payment.
- State commits to an ADEC "plus" payment beginning in FY2024, growing to $15 million in FY2026 and remaining at that level until fund reaches 90% funded.
- Prefund OPEB
  - Normal cost = Education Fund
  - UAL amortization costs = General Fund

JFO

VSTRS Proposed Contribution Rates

- Beginning in FY2023, increase the contribution rates for all active members over a 3-year period according to the following marginal rate structure:

Base Salary Level	Year 1 Rate	Year 2 Rate	Year 3 Rate
$0-$40,000	6.00%	6.25%	6.25%
$40,000.01-$60,000	6.50%	6.75%	6.75%
$60,000.01-$80,000	6.75%	7.00%	7.50%
$80,000.01-$100,000	7.00%	7.50%	8.25%
$100,000.01 +	7.25%	8.00%	9.00%

- Effective contribution rates would be calculated annually based on a member's base salary as of July 1 and assessed on the member's total compensation during the fiscal year.
- Employee contribution revenue offsets employer normal cost (ADEC) which is charged to Education Fund.

VSTRS Preliminary Estimates of Additional Revenue from Contribution Changes ($ millions)				
	FY2023	FY2024	FY2025	Comments
Employee contribution increases – phased, marginal rates with 3/year phase-in	6.2	8.7	10.3	Additional revenue offsets employer normal cost expenses to Education Fund (a component of the ADEC). JFO estimate based on active salary data and 3% annual growth assumptions.

JFO

Estimates are preliminary and may fluctuate due to additional actuarial analysis, timing, or gains/losses from other factors.

VSTRS Proposed COLA Changes

- Beginning July 1, 2022, modify the COLA structure by:
  - Amending the minimum and maximum amounts of any increases/decreases used to determine the net percentage change in the CPI from the current 1% minimum/5% maximum to 4% maximum.
  - Requiring a member to receive a retirement benefit for at least 24 months of prior to receiving a COLA, an increase from the current 12-month requirement.
  - Actives who are eligible for normal (unreduced) retirement on or before 6/30/2022 are exempt from the changes above.

VSTRS Preliminary Estimates of Fiscal Impacts of Plan Changes ($ millions)

Plan Change	ADEC	Normal Cost	Unfunded Liability	Comments
COLA CPI formula 0% min, 4% max	-2.8	-1.0	-20.1	Per actuarial estimates from Segal. Numbers reflect individual impact of the two options without exemptions and may change in combination with other changes.
COLA 24+ months of retirement	-2.0	-0.6	-14.8	
COLA When VSTRS 80%+ funded, CPI formula increases 7.5%.				Fiscal impact not yet actuarially estimated. However, 7.5% increase does not apply if doing so is projected to cause the fund to drop below 80% funded.

Estimates are preliminary and may fluctuate due to additional actuarial analysis, timing, or gains/losses from other factors.

The proposed VSTRS pension COLA changes could save approximately $4.8 million in ADEC costs (across all funds), and reduce unfunded liabilities by approx. $34.9 million.

VSTRS Proposed COLA Changes

- *<u>Task Force Recommendation:</u>* For members who leave active service on or after June 30, 2023:
  - Increase the 50% of CPI COLA formula by 7.5%/year once the pension system reaches 80% funded, provided that the increase does not result in the fund projected to fall below 80%. If the increase would result in the fund dropping below 80% funded, then the formula is paused at the levels in place at the time pending re-evaluation next year.
- However, establishing this future benefit in statute *now* will increase the ADEC by approx. $16M and UAL by approx. $105M due to the need to prefund the expected future benefit.
- *<u>S.286:</u>*
  - Includes legislative intent to provide future benefit enhancements to members who paid the higher contributions in effect beginning in FY 2023 once the pension system is 80% funded.
  - Establishes a Postretirement Adjustment Allowance Fund (PAAF) to accumulate assets from the General Fund surplus. When the Fund has enough money to pay for the actuarial cost of a benefit enhancement, the enhancement could be enacted into statute by the Legislature and "funded" with the assets accumulated in the PAAF.

JFO

VSTRS Proposed Additional Employer Contributions

- Make a one-time payment in FY2022 of $75 million (50% of the $150 million currently in reserve), plus an additional $50 million ($125 million total) toward the unfunded pension liability.
- Will result in ADEC savings 2 years after the payment (approx. $12.2 million in FY2024 that grows in future years).
- Beginning in FY2024, make an ADEC "plus" payment toward the unfunded liability that ramps up to $15 million by FY2026 and remains at that level until the fund is 90% funded.
  - Effectively redirecting future ADEC savings from the one-time funding in FY2022 toward additional pay down of unfunded liability.
- Reconfigure the year-end General Fund surplus construct to dedicate 25% to the VSTRS pension.
  - **S.286 sends the 25% VSTRS share to the Postretirement Adjustment Allowance Fund.**

VSTRS Preliminary Estimates of Fiscal Impacts of Plan Changes ($ millions)				
Plan Change	**ADEC**	**Normal Cost**	**Unfunded Liability**	**Comments**
$125 million one-time payment	-12.2 (FY24)		-125.0	Impact of funds will reduce ADEC beginning 2 years following payment. Actual savings likely to vary slightly from actuarial estimate provided due to timing.
ADEC "Plus" payments ($15M by FY2026) and 25% of General Fund surplus				Fiscal impact not yet actuarially estimated but will result in future ADEC and UAL savings. Impact of General Fund surplus will vary based on timing and magnitude of contributions.

JFO

Estimates are preliminary and may fluctuate due to additional actuarial analysis, timing, or gains/losses from other factors.

VSTRS OPEB Proposal

- Enact a prefunding schedule into statute (ADEC).
- Use $13.3 million of Education Fund money currently in reserve to begin prefunding.
- Charge the normal cost to the Education Fund, similar to how pensions are funded.
  - Normal cost = What should be paid into the system over the course of an active member's career to fund their future benefit.
- Charge the unfunded liability cost to the General Fund.
- Remove sunset on Local Education Agency contributions for teachers hired after 7/1/15.

		Onetime $s				
		FY22	**FY23**	**FY24**	**FY25**	**FY26**
Teachers' -Retiree Healthcare Fund						
	EF Onetime $s anchor prefund volitility -Beth memo	**13.3**				
	EF Retirement Healthcare for Active Teachers -Normal Cost		15.1	15.6	16.0	16.5
	GF - healthcare costs for already retired teachers		35.1	36.1	37.2	38.3
	Total Retiree Healthcare Fund - with Prefunding		**50.2**	**51.7**	**53.3**	**54.9**
	Unfunded Healthcare Liability current paygo		*1,504.5*			
	Unfunded Healthcare Liability with prefunding		*667.8*			
	Reduction in Unfunded Liability on the state balance sheets		*(836.8)*			

Estimates are preliminary and may fluctuate due to additional actuarial analysis, timing, or gains/losses from other factors.

OPEB Prefunding

<u>Prefunding</u> OPEB will reduce the state's unfunded retirement liabilities by more than $1.7 billion.

- VSERS: $891.3 million savings
- VSTRS: $836.8 million savings

Table 6: **Estimated Impact of Prefunding OPEB**

	State Employee OPEB			**Teacher OPEB**		
	FY 2023 – Status Quo Paygo	**FY 2023 – Prefunding**	**Change**	**FY 2023 – Status Quo Paygo**	**FY 2023 – Prefunding**	**Change**
1. Rate of Return	2.41%	7.00%		2.20%	7.00%	
2. Actuarial Accrued Liability	$1,787,402,771	$901,630,521	($885,772,250)	$1,519,502,091	$683,414,665	($836,087,426)
3. Fund Assets	$123,166.267	$128,686,560	$5,520,293	$14,955,429	$15,657,836	$702,407
4. Unfunded Liability (2-3)	$1,664,236,267	$772,943,961	($891,292,306)	$1,504,546,662	$667,756,829	($836,789,833)
5. Normal Cost	$66,216,417	$20,897,140	($45,319,277)	$56,584,557	$15,104,597	($41,479,960)
6. Amortization of Unfunded Liability	$55,898,305	$43,680,845	($12,217,460)	$52,403,565	$39,709,031	($12,694,534)
7. Total ADEC (5+6)	$122,114,722*	$64,577,985	($57,536,737)	$108,988,122*	$54,813,628	($54,174,494)

(*) Under Status Quo Paygo, the OPEB ADEC is not fully funded. Instead, only the paygo cost of providing benefits to current retirees is appropriated. The proposed prefunding policy will require the ADEC (both the normal cost and the unfunded liability amortization payment) to be fully funded in future years.

Source: FY 2021 GASB 74 Valuations

Estimates are preliminary and may fluctuate due to additional actuarial analysis, timing, or gains/losses from other factors.

JFO

Fiscal Impacts

Table 7: **Preliminary Estimates of Anticipated FY23 Budget Impact of S. 286**
($ millions)

State Employees	FY23	
Current FY23 Budget For Employer Contribution		
Pension - Normal and Unfunded Liability	124.2	all funds
OPEB/Retiree Health Care- PayGo	43.7	all funds
Total (payroll assessment funded)	**167.9**	all funds
S.286 Estimate Budget Need	**FY23**	
Pension - Normal and Unfunded Liability	112.7	all funds
OPEB Prefund - Normal and Unfunded Liability	64.6	all funds
Total (payroll assessment funded)	**177.3**	all funds
FY23 Total Budget Impact	**9.4**	GF FY23
Address with $10 million onetime GF in FY23, a transition year to help agencies and departments unable to absorb the increase in payroll assessment needed for FY23		

Teachers	FY23	
Current FY23 Budget For Employer Contribution		
Pension - Normal	40.7	Ed Fund
Pension - Unfunded Liability	157.5	GF
OPEB/Retiree Health Care- PayGo	29.6	GF
Total	**227.8**	all funds
S.286 Estimate Budget Need	**FY23**	
Pension - Normal	32.9	Ed Fund
Pension - Unfunded Liability	154.3	GF
OPEB Prefund - Normal	15.1	Ed Fund
OPEB Prefund - Unfunded Liability	35.1	GF
Total	**237.4**	all funds
FY23 Budget Impact		
Education Fund - OPEB	15.1	
Education Fund - Pension	-7.8	
General Fund - OPEB	5.5	
General Fund - Pension	-3.2	
Total	**9.6**	

Table 8: **Summary of Estimated Impacts by System**
($ millions)

	State Employees	Teachers
Current System (FY 2021)		
Pension Unfunded Liabilities	1,064.4	1,950.4
OPEB Unfunded Liabilities	1,473.1	1,275.6
New State Resources		
FY 2022 General Fund - Pension	75.0	125.0
FY 2022 OPEB Prefunding One-Time	52.4 (GF)	13.3 (EF) – FY2022 5.5 (GF) – FY 2023
FY 2023 OPEB Base (all funds)	22.2	15.1 (EF)
Totals	**149.6**	**153.4**
OPEB Unfunded Liability Reduction	**-891.3**	**-836.8**
Pension Unfunded Liability Reduction		
One-time funds	-75.0	-125.0
Benefit modifications	-58.0	-35.0
Total	**-133.0**	**-160.0**
Total Estimated Unfunded Retirement Liability Reductions	**-1,024.3**	**-996.8**

Note: Table does not reflect anticipated positive impacts of additional ADEC payments toward unfunded pension liabilities that begin in FY 2024. Estimates are preliminary and subject to change from further actuarial analysis and plan experience.

Estimates are preliminary and may fluctuate due to additional actuarial analysis, timing, or gains/losses from other factors.

S.286 – Miscellaneous Items

- Bill also contains several clarifying amendments to language contained in Act 75 (2021).

- Act 75 stipulated that:

  - VPIC shall perform asset and liability studies on a three-year basis beginning on 7/1/22.
  - Experience studies shall be performed at least once every three years.

- S.286 clarifies that:

  - “Every three years” means “every three <u>fiscal</u> years”
  - Delays the start of the three-year requirements so the upcoming studies can include FY 2023 data.
    - Most recent experience studies were done at the end of FY 2019. The next studies (status quo) would be based on FY 2020, 2021, and 2022 data.
    - Changes under consideration mostly take effect in FY 2023.
    - S.286 would provide the three Retirement Boards and VPIC with the <u>option</u> of waiting until the end of FY 2023 to do these studies in order to reflect the legislative changes, then maintaining the three-year cycle for each retirement system after 7/1/2023.
    - Although none of the other changes impact VMERS, VMERS is included in this section to maintain the administrative convenience of having all three systems do experience studies on the same cycle.

JFO