Testimony Points

- Review of Assumptions and How They Are Developed
- Investment/Other Gains and Losses
- Need for OPEB Funding
- Discussion Points with Committee

Pension Funding:

- Measured by an Independent Actuary through an annual valuation
  - Reviewed by the Board of Trustees
  - Board recommendation made to the Governor for the funding of the plan

- Assumptions are reset through an experience study, to be completed, per statute, at least every five years
  - Full experience studies completed for 2002, 2007, 2011, 2015, 2020
  - Partial experience study completed in 2017

- Three Important Factors:

  - Pension Status
  - Pension Liabilities
  - Assets Available to meet these liabilities

- Is Employer Contributing to Plan at the Recommended Rate

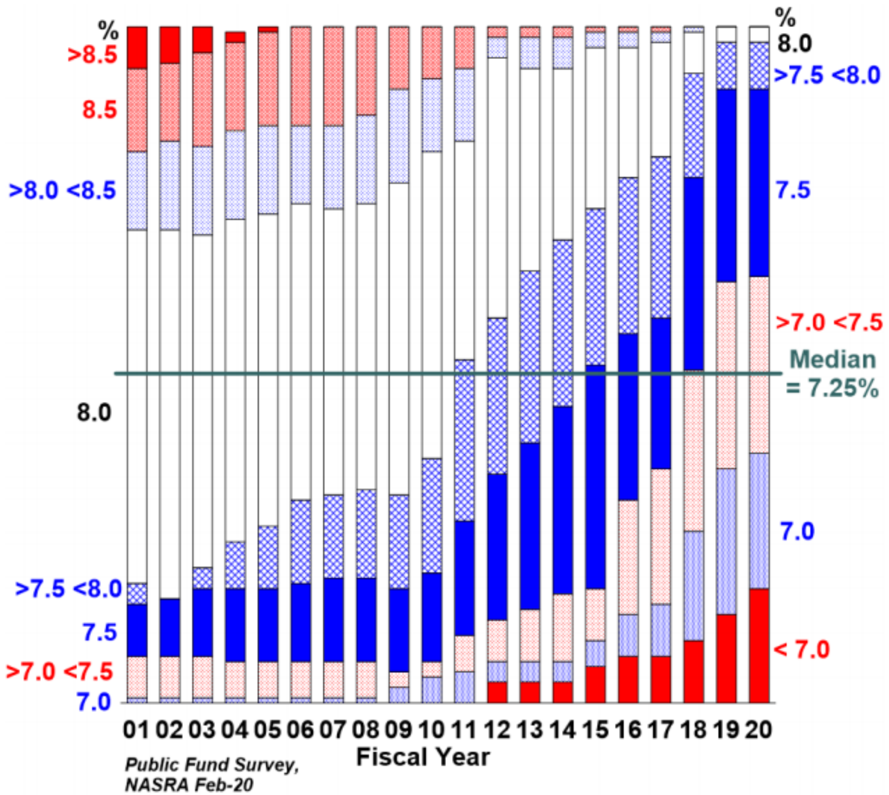
  - Actuarially Determined Employer Contribution (ADEC)

- Plan in place to retire the unfunded liability

- Between 2010 and estimated through 2038, initiatives to date have reduced pension and OPEB costs by approximately $1.5 billion.

National Trend in Rate of Return

Distribution of Historical Return Assumptions



Since 2001, the median investment return assumption has been moving downward and this trend is expected to continue as more systems complete experience review cycles.

Upward Budget Pressures on Funding Status and ADEC

- Experiencing Declining Assumed Rates of Returns- National Trend, not just VPIC
- Mortality
- Investment Losses in Great Recession include in 2008-2010 valuation reports and; trend consistent with other pensions across country, sustained significant losses
  - VSERS:
  - Retirement Experience including Retirement Incentives adopted by Legislature
    - Salaries per assumed levels
    - Investment returns are not the primary factor
  - Teacher:
    - Retirements/ Teacher Turnover – related to pressures on local budgets, school reorganization, and more recently COVID. Single largest source of pension losses outside of assumption changes
    - Continued funding of health care in pension fund without sufficient appropriation.
    - Prior underfunding of ADEC contributed to lower levels of funding (compared to VSERS and VMERS, coming out of Great Recession
    - Investment returns pale in comparison to demographics and lack of funding

Actuarial Gains or Losses

- A pension plan has actuarial gains or losses each year because the actual events during the year
- Economic Gains/Losses: Gains or losses on plan assets occur because the actual investment returns were higher or lower than anticipated
- Experience and Demographic Gains or losses: Can occur because long-term assumptions (e.g., mortality, salary increases, termination, retirement) were not met
- An experience study is completed to reset assumptions. Largest increases in unfunded liability are due to changes in assumptions, many of which follow national trends.

Gains/Losses - VSERS

Post recession numbers are stated in 2011-2020 column.
As expected, assumption changes are largest driver although each system has other gains/losses

Negative numbers are gains, positive numbers are losses

Components of Change in the Unfunded Actuarial Liability -VSERS		
Category	Cumulative 2007-2020	Cumulative 2011-2020
Beginning FY Unfunded liability	$ 9,044,004	$ 293,920,094
Changes in Actuarial Assumptions	480,841,346	489,354,525
Changes in System Provisions	47,465,002	22,252
Incorporation of Temp Salary Decreases	(69,913,212)	-
Change in employee contribution rate	(2,610,261)	(2,610,261)
All other expected increases/reductions	(57,597,843)	(79,843,570)
Other expense gain/loss	8,798,318	9,482,240
Salary experience gain/loss	88,151,220	95,627,506
COLA experience gain/loss	(123,583,917)	(110,469,758)
Net Turnover (new mmbers, terminations)	77,509,729	61,630,140
Investment gain/Loss	317,484,349	56,205,931
Mortality gain/loss	40,982,471	40,657,045
Retirements gain/loss	128,594,128	97,520,027
Disability experience gain/loss	2,590,399	2,357,312
Other gain/loss	92,709,386	86,611,636
Ending FY Unfunded Liability	$ 1,040,465,119	$ 1,040,465,119

Gains/Losses - VSTRS

Post recession numbers are stated in 2011-2020 column.
As expected, assumption changes are largest driver although each system has other gains/losses

Negative numbers are gains, positive numbers are losses

Cumulative Changes in Liability		
	2007-2020	2011-2020
Beginning FY Unfunded liability	$259,108,435	$711,823,061
Expected adj. not incl. assumption/benefit changes	37,199,874	(5,786,660)
Assumption Changes	828,540,973	783,238,313
Plan Provisions	(46,409,122)	0
Net Investment	384,996,680	52,038,767
Salary	(129,391,882)	(125,779,835)
COLA	(102,730,234)	(88,185,397)
Mortality	18,350,215	20,000,804
Retirement	184,010,383	162,532,393
Disability	3,761,046	2,670,773
Net Turnover	320,448,149	319,901,420
Contribution Shortfall incl. Health Care Approp.	175,907,621	101,499,179
Other Gains/Losses	(502,768)	(663,448)
Ending FY Unfunded Liability	$1,933,289,366	$1,933,289,366

For 2007-2020 totals, investment losses during Great Recession accounts for $284.7 million of the losses). 2011-2020 peri removes this one time (hopefully) event.

Investment Loss as a Percentage of Increase In liabilities

VSTRS-2007-2020 19.1% VSERS- 2007-2020 30.8% During greatest economic downturn since the Great Depression	VSTRS-2011-2020 4.3% VSERS- 2011-2020 7.5% Post Great Recession- investment losses pale in comparison to other components

Actuary (Segal) Comments on Investment Gains and Losses

- "It is also important to note that the investment return assumption is only one of many economic and demographic assumptions that are used to determine the liabilities of a pension plan. Assumptions are used to estimate a plan's future benefit payments and their present value and do not determine outcomes. Specifically, the investment return assumption does not affect the performance of the fund, nor should an actuarial assumption dictate asset allocation or investment policy."

- "…investment losses represent a small portion of the increase in the unfunded liability over the time period (2009-2018). Changes in assumptions, primarily lowering the investment return assumption, non-investment related experience, and the transfers to fund retiree health benefits were much more significant."

Transparency

- Annual Report (contains all legislative reporting)
  - Trustee Board Retirement Division Activity
  - Pension actuarial history and funding status
  - OPEB actuarial history and funding status
  - Actuarial balances
  - Fund statements w/balance sheet

- Treasurer's Office Website
  - Investment performance
  - Actuarial reports –current and historical
  - Experience studies- current and historical
  - Reports on underfunding of VSTRS
  - 2009 Commission
  - Investment Policies
  - ESG Policies
  - Code of ethics
  - Other reports available, including reports on request

- <u>Would look to partner with General Assembly on more formalized reporting requirements in statute.</u>

Pay-Go versus Pre-Funding?

PAY - Go

Contributions
- VSTRS - $35.1M

Premium Payments (Benefits)
FY 22 Gov. Budget
- VSTRS - $35.1M

All Contributions are used for Benefit Payments

Est. OPEB Liability in FY22
- VSTRS - $1,480,695,611

Why?

Investment Proceeds Create Savings $821,846,460

Pre-Funding

Contributions
- VSTRS - $41.8M + 13.3M One-Time

Premium Payments (Benefits)
FY 22 Gov. Budget
- VSTRS - $35.1M

Excess Contributions are Invested for Future for Benefit Payments

Est. OPEB Liability in FY22
- VSTRS - $658,849,151

Pre-Funding is simply committing to pay more than the Pay-Go so that investment earnings can fund Future Benefits

Prefunding of the VSERS OPEB would reduce liabilities by $861.9 million

Guiding Principles for a Retirement Plan

Fairness and Sustainability Are Both Essential to Benefit Plans

What Do We Want From Our Retirement Benefit Plan?

- **Recruitment – The benefit plan should act as an incentive for recruiting high quality employees. The plan must be competitive with those in other states and within Vermont.**
- **Retention – The benefit plan should act as an incentive for retaining high-quality employees and maintaining a stable workforce. The plan should also be compatible with changing workforce and demographic trends.**
- **Reward – The benefit plan should provide a solid foundation for retirement security following a career in public service.**
- **Sustainability – The cost of the benefit plan should be sustainable and predictable over the long term.**
- **Affordability – The cost of the benefit plan should be affordable for current and future public employees and other taxpayers.**
- **Fairness – The benefit plan should be fair to workers and other taxpayers.**
- **Equity – The benefit plan should be equitable for all parties.**

The Pension Challenge

- Funding for retirement benefits, including health care, is among the largest fiscal challenges facing many state governments, including Vermont

- Health insurance has historically grown much faster than the rate of revenue growth

- Investment losses from the Great Recession significantly impacted pension funding

- At the same time, retirement security is important to Vermont’s economic future

- Maintaining a disciplined approach is important to meet these challenges

- Begin pre-funding of OPEBs!