OPEB OVERVIEW

Vermont Legislative
JOINT FISCAL OFFICE

Chris Rupe

Fiscal Analyst

Joint Fiscal Office

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What is OPEB?

Other Post-Employment Benefits

- Retirement benefits "other" than pension benefits.
- **Subsidized retiree health care** is the primary example.
- **Prescription coverage**
- **Dental coverage** also offered to retirees and eligible dependents, but at full premium cost to the member.
- **Life insurance** (VSERS)

- VSERS Health Care Information
- VSTRS Health Care Information

The Big Four Liabilities

Pension and OPEB liabilities collectively total **$9.815 billion (and growing).**

Thanks to prefunding, there are enough assets to fund **$4.157 billion** (42%) of these costs, mostly on the pension side. OPEB remains funded on a pay-as-you-go basis with minimal prefunding.

The shortfall needed to fully pay for pension and OPEB liabilities totals **$5.658 billion** – roughly $9,068 for every Vermonter.

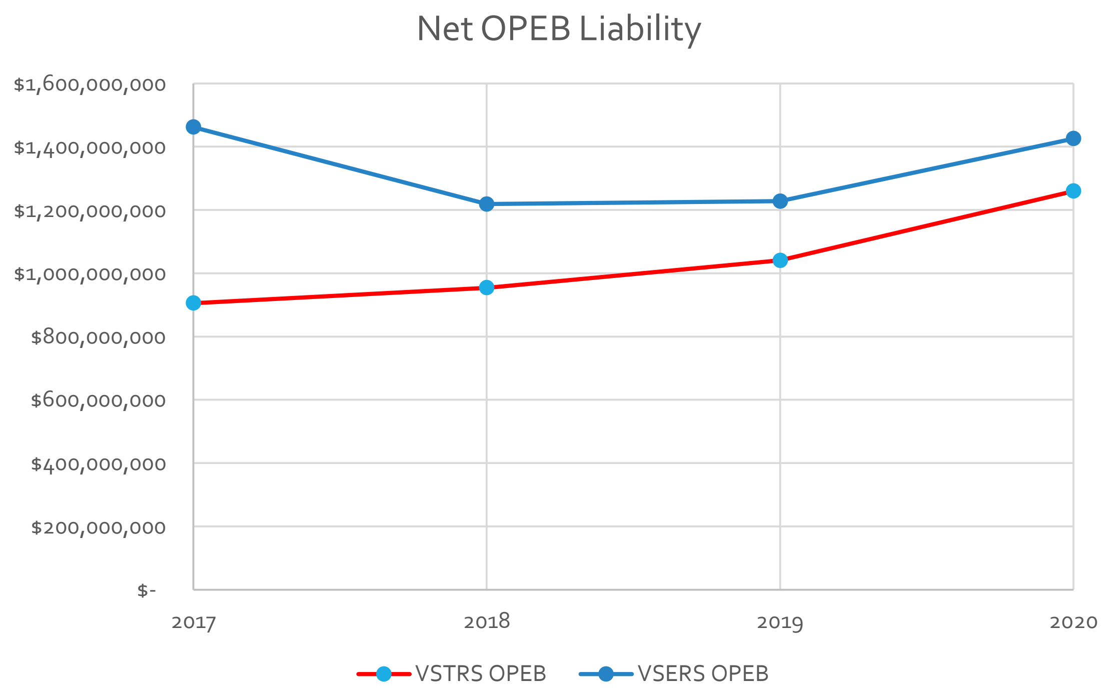
	VSERS Pension	VSTRS Pension
Actuarial Accrued Liability	$3,095,290,972	$3,969,002,977
Actuarial Value of Assets	$2,054,825,853	$2,035,713,611
Unfunded Liability	$1,040,465,119	$1,933,289,370
Funded Ratio	66.4%	51.3%

	VSERS OPEB	VSTRS OPEB
Total OPEB Liability	$1,482,970,357	$1,268,119,008
Assets (Fiduciary Net Position)	$57,592,708	$8,718,699
Net OPEB Liability	$1,425,377,649	$1,259,400,309
Assets as % of Total Liability	3.88%	0.69%

As of end of FY20

Recent Net OPEB Liability Trends

In recent years, the state's Net OPEB Liabilities have grown by $317.1 million (13.4%).



OPEB Background

- State employees are entitled to continue their health coverage into retirement (3 V.S.A. §479) . A Retired Employees' Committee on Insurance is created in statute to review and recommend changes to the Secretary of Administration on retiree health benefit (3 V.S.A. §636)

- A State Employees' Postemployment Benefits Trust Fund exists to accept contributions to provide post-employment health insurance to eligible retirees. Fund managed by State Treasurer. (3 V.S.A. §479a)

- VSTRS provides postemployment healthcare benefits to eligible VSTRS retirees. VSTRS has the statutory authority (16 V.S.A. §1944e) to establish and amend the benefit provisions of the plan.

- A Retired Teachers' Health and Medical Benefits Fund (RTHMB) exists to accept contributions to provide post-employment health insurance benefits to eligible retirees. RTHMB is self-insured through Vermont Education Health Initiative. Employer must absorb volatility in costs but can also save money in years when costs are below projections .

- Contribution/subsidy percentage rates are in statute and negotiated.

- OPEB is not the same as pensions! Case law is not as clear as to whether OPEB benefits constitute a contractual right to premium coverage and OPEB benefits are not paid from the pension funds or included in pension benefits.

OPEB Retiree Health Insurance Subsidies

Vermont's OPEB benefits generally allow a member to continue their health care coverage into retirement. The coverage is subsidized based on the employee's years of service.

Plans interact with Medicare and provide some wrap-around coverage for services that Medicare does not cover. Employee Group Waiver Plans for prescriptions and "wraps" have led to cost savings for Medicare-eligible retirees.

VSERS Group F	
Years of Service at Retirement	**Subsidy**
5-9 years	Buy-in
10-14 years	40%
15-20 years	60%
20+ years	80%

VSTRS Group C2	
Years of Service at Retirement	**Subsidy**
Less than 15 years	0%
15-19 years	60% single
20-24 years	70% single
25 + years	80% single or spousal

OPEB Costs

VSERS OPEB costs are charged to different cost centers in the government with an estimated 40% falling to the General Fund.

VSTRS OPEB costs are primarily funded by the General Fund. However, subsidies from the Employee Group Waiver Plan and from charges paid by school employers on more recently hired teachers help to offset these costs

FY22 GOVREC	VSERS	VSTRS
General Fund	$14,882,608 (40% est.)	$35,093,844
Other Funds	$22,323,913 (60% est.)	$414,832
New Teacher Health Care Employer Charges		$4,108,428
Employee Group Waiver Plan subsidies		$2,951,944
Total:	**$37,206,521**	**$42,569,048**

General Fund OPEB Costs ($ million)				
	FY19	**FY20**	**FY21**	**FY22**
State Employee OPEB	$14.8	$14.9	$14.8	$14.9
Teacher OPEB	$31.6	$31.1	$31.8	$35.1

OPEB Liabilities

- Just like with pensions, GASB rules require states to report their long-term OPEB liabilities on their financial statements. GASB 74/75 require OPEB liabilities to be reported separately from pensions.

- OPEB accrued liabilities do not presently directly impact primary funds such as the General Fund. However, the actual cost of paying the current-year premiums does impact these funds because those current-year premiums are paid on a pay-as-you-go basis through appropriations. The accrued liabilities also impact the state's balance sheet, which may impact bond ratings and borrowing costs.

- Like with pensions, **prefunding OPEB is a more financially prudent course of action than paygo**, as prefunding allows the system to take advantage of investment gains to pay for the cost of benefits and takes pressure off operating budgets.

- Vermont's OPEB plans are minimally prefunded and there is no prefunding policy codified into statute.
  - VSERS: $57.6 million prefunded (3.88% of OPEB liability)
  - VSTRS: $8.7 million prefunded (0.69% of OPEB liability)

- In the past, teacher OPEB healthcare costs were paid from the VSTRS pension system and treated as an actuarial loss to the pension system. This practice ended in 2014 and was a contributing factor to the challenges facing the VSTRS pension system.
  - VSERS OPEB costs were historically funded on a paygo basis – not from the VSERS pension system.

OPEB History

- Previous OPEB efforts have often focused on ways to reduce liabilities/costs, such as changing the benefit structure for new employees hired after July 2008 (VSERS) and implementing a tiered health care benefits structure in 2010 (VSTRS).

- Implementing Employee Group Waiver Plans has helped to curb increased costs for prescription coverage, and charging OPEB costs to federal grants has also generated additional revenue..

- Additional contributions from school employers and newly hired teachers were implemented in recent years.

- The practice of paying for teacher OPEB out of the VSTRS pension system ended in 2014.

- A larger funding plan was developed in 2014 to prefund OPEB by 2038 but that plan was not consistently adhered to.

- Statutory change in 2020 gave the Treasurer the ability to invest prefunded OPEB assets with VPIC to earn a higher rate of investment return.

- **But despite these changes, the paygo model continues with very minimal levels of prefunded assets in trust and no statutory prefunding plan in place.**

OPEB Prefunding

According to the State Treasurer, the lack of pre-funding OPEB liabilities, in and of itself, is responsible for **$1.68 billion** of Vermont's accrued OPEB liabilities.

- With prefunding, the state can calculate its unfunded liabilities by applying a discount rate based on anticipated investment performance of the plan assets over time. The pension systems currently use a 7.0% assumed rate of return.

- Without prefunding, the state must use a standardized discount rate prescribed by GASB – the 20-year AA municipal bond rate. This rate varies from year to year based on the interest rate market, rather than on Vermont's investment experience. Currently this rate is 2.23% for VSERS and 2.21% for VSTRS, down from 3.50% a year ago.

- Federal monetary policy has driven down interest rates recently. As interest rates decline, the unfunded OPEB liabilities increase. **The impact of declining interest rates increased the unfunded net OPEB liabilities by $488 million in 2020 just from this factor** (though this impact was somewhat offset by other factors that reduced net OPEB liabilities)**:**

    - VSERS: $256 million increase in net OPEB liability due to reduced discount rate
    - VSTRS: $232 million increase in net OPEB liability due to reduced discount rate

OPEB Liabilities

Due to the lack of prefunding, OPEB liabilities are calculated using a discount rate pegged to the AA municipal bond rate rather than an assumed rate of investment return.

Reductions in the discount rate due to federal monetary policy increased OPEB liabilities for both systems by a total of $488 million. Otherwise, overall liabilities would have decreased below expected levels due to plan experience factors.

Data from State Treasurer's Report to the General Assembly on Recommendations to Reduce Pension and OPEB Liabilities, January 15, 2021.

$ millions	VSERS	VSTRS
Accrued Liabilities as of June 30, 2019	**$1,279**	**$1,041**
Expected Accrued Liabilities as of June 30, 2020	**$1,335**	**$1,081**
Changes From:		
Differences Between Expected and Actual Experience	$20	$31
More/less per capita claims than expected	($105)	($45)
Updated contribution rates	$27	$79
Health Trend rates (updated from 2020 Health Trend Analysis)	($43)	($24)
Excise tax repealed	($19)	($46)
Mortality rates (updated from pension experience study)	($10)	$20
Disability rates (updated from pension experience study)	$0	-
Withdrawal rates (updated from pension experience study)	$0	$17
Retirement rates (updated from pension experience study)	$28	($8)
Salary scale (updated from pension experience study)	($6)	($6)
Percent married	-	($60)
Enrollment	-	($3)
Discount rate (decrease from 3.5% to 2.23% for VSERS, 2.21% for VSTRS)	$256	$232
Accrued Liabilities as of June 30, 2020	**$1,483**	**$1,268**

Path to Prefunding

- Like with pensions, a prefunded OPEB system would require the employer to set aside a calculated amount of money above and beyond the paygo cost of premiums to build up a pool of assets that can be invested long-term. Like pensions, actuaries can calculate an ADEC amount that must be paid into the system to pay off the liabilities by the amortization date.

- BUT - moving to prefunding would NOT necessarily require the state to fully fund the ADEC amount on Day 1!

- Instead, the state could move to prefunding by incrementally increasing its appropriation above the paygo amount in accordance with a statutorily defined funding policy. The state, at a minimum, would have to commit to incremental increases in statute that meet or exceed the rate of inflation over the full amortization period. The funding policy must ensure that projected contributions (plus investment returns) will be able to pay future benefit costs, and that the fund will not run out of money before all benefits are paid (in accordance with GASB rules).

- The amount of incremental increases needed to adequately prefund is influenced by how large the starting balance is, future projected benefit costs, and demographic/economic assumptions.

- Prefunding would have immediate benefits to the state:

    - Allows the state to take advantage of investment returns to reduce future costs.
    - Would lower the state's unfunded OPEB liabilities by $1.68 billion.
    - Would create predictability in future OPEB costs.

VSERS

Moving to prefunding and adopting a 7% rate of return would lead to a **$859 million** reduction in VSERS OPEB accrued liability.

Section 2: Valuation Results

Actuarially Determined Contribution

	Year Ending June 30, 2022	% of Payroll	Year Ending June 30, 2021	% of Payroll
Rate of Return	**2.23%**		**3.50%**	
Actuarial Accrued Liability	$1,675,647,526	270.30%	$1,387,574,090	233.64%
Health Care Fund Assets	58,877,025	9.50%	53,543,393	9.02%
Unfunded Actuarial Accrued Liability	$1,616,770,501	260.80%	$1,334,030,697	224.62%
Normal Cost	$61,073,378	9.85%	$42,381,859	7.14%
Amortization of Unfunded Actuarial Accrued Liability	48,634,653	7.85%	47,643,953	8.02%
Total Actuarially Determined Contribution	$109,708,031	17.70%	$90,025,812	15.16%
Total Payroll	$619,919,869		$593,900,965	
Rate of Return	**7.00%**		**7.50%**	
Actuarial Accrued Liability	$816,505,857	131.71%	$794,041,692	133.70%
Health Care Fund Assets	61,624,198	9.94%	55,612,703	9.36%
Unfunded Actuarial Accrued Liability	$754,881,659	121.77%	$738,428,989	124.34%
Normal Cost	$18,032,856	2.91%	$16,205,068	2.73%
Amortization of Unfunded Actuarial Accrued Liability	40,751,876	6.57%	42,003,509	7.07%
Total Actuarially Determined Contribution	$58,784,732	9.48%	$58,208,577	9.80%
Total Payroll	$619,919,869		$593,900,965	

For the year ending June 30, 2021, the Normal Cost and Actuarially Accrued Liability were determined using the Projected Unit Credit actuarial method and a 3.50% and 7.50% rate of return. Assets were projected forward from June 30, 2019 assuming the System contributes the amount of expected benefit payments for the year ending June 30, 2020. The Unfunded Actuarially Accrued Liability was amortized using a closed 28 year amortization period calculated as a level percent of projected payroll, with an assumed annual payroll growth of 3.50%.

For the year ending June 30, 2022, the Normal Cost and Actuarially Accrued Liability were determined using the Projected Unit Credit actuarial method and a 2.23% and 7.00% rate of return. Assets were projected forward from June 30, 2020 assuming the System contributes the amount of expected benefit payments for the year ending June 30, 2021. The Unfunded Actuarially Accrued Liability was amortized using a closed 27 year amortization period calculated as a level percent of projected payroll, with an assumed annual payroll growth of 3.50%.

VSTRS

Moving to prefunding and adopting a 7% rate of return would lead to a **$821 million** reduction in VSTRS OPEB accrued liability.

Section 2: Valuation Results

Actuarially Determined Contribution

	Year Ending June 30, 2022	% of Payroll	Year Ending June 30, 2021	% of Payroll
Rate of Return	**2.21%**		**3.50%**	
Actuarial Accrued Liability	$1,489,606,993	224.69%	$1,069,220,408	164.44%
Health Care Fund Assets	8,911,382	1.34%	323,013	0.05%
Unfunded Actuarial Accrued Liability	$1,480,695,611	223.34%	$1,068,897,395	164.39%
Normal Cost	$52,625,330	7.94%	$27,189,374	4.18%
Amortization of Unfunded Actuarial Accrued Liability	49,528,078	7.47%	40,722,830	6.26%
Total Actuarially Determined Contribution	$102,153,408	15.41%	$67,912,204	10.44%
Total Payroll	$662,965,166		$650,224,622	
Rate of Return	**7.00%**		**7.50%**	
Actuarial Accrued Liability	$668,178,159	100.79%	$594,912,834	91.49%
Health Care Fund Assets	9,329,008	1.41%	335,497	0.05%
Unfunded Actuarial Accrued Liability	$658,849,151	99.38%	$594,577,337	91.44%
Normal Cost	$13,835,778	2.09%	$10,707,251	1.65%
Amortization of Unfunded Actuarial Accrued Liability	38,332,816	5.78%	35,657,941	5.48%
Total Actuarially Determined Contribution	$52,168,594	7.87%	$46,365,192	7.13%
Total Payroll	$662,965,166		$650,224,622	

For the year ending June 30, 2021, the Normal Cost and Actuarially Accrued Liability were determined using the Projected Unit Credit actuarial method and a 3.50% and 7.50% rate of return. Assets were projected forward from June 30, 2019 assuming the System contributes the amount of expected benefit payments for the year ending June 30, 2020. The Unfunded Actuarially Accrued Liability was amortized using a closed 28 year amortization period calculated as a level percent of projected payroll, with an assumed annual payroll growth of 3.00%.

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Potential Paths Forward

- The Retired Teachers' Health and Medical Benefits Fund (RTHMB) has an $8.7 million fund balance from a one-time increase in Employee Group Waiver Plan (EGWP) reimbursements recognized during FY20. This amount is **insufficient** to pursue a prefunding strategy without both ongoing appropriations in excess of the paygo amount and a funding policy codified in statute that commits the state to making those higher appropriations.

- The state OPEB trust has a balance of $57.6 million which could help start prefunding but is not, itself, a sufficiently large amount to base a prefunding strategy on. Any excess reserves in state health funds or other one-time revenue sources could be used as additional sources of prefunding (rather than for providing temporary rate holidays, for example).

- Prefunding will require the legislature to adopt (and adhere to) a statutory funding plan to pay the ongoing premium cost **PLUS** some amount above and beyond that cost toward prefunding (or pay according to the ADEC).
  - The plan must pass a 'crossover' analysis performed by the actuaries to ensure that there will be sufficient funds in the system to pay for future benefit costs in accordance with GASB.
  - Infusions of large one-time funds will be helpful in the near-term but will be insufficient to put the state on a path to prefunding without an accompanying statutory funding policy and additional escalating appropriations in the future until prefunding is achieved.

- State should consider additional opportunities to contain costs/liabilities – particularly in response to any federal health care policy changes.

THANK YOU!

Questions?

crupe@leg.state.vt.us

Links:

[VSERS OPEB GASB74 Actuarial Valuation and Review]

[VSTRS OPEB GASB74 Actuarial Valuation and Review]