

OPEB Overview

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Vermont Legislative
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OPEB Costs

OPEB = Other Post Employment Benefits (subsidized retiree health care)

Vermont does not currently prefund OPEB expenses. Rather, these benefits are funded on a pay-as-you-go basis. In other words, the taxpayers pay for the actual cost of providing health care to current retirees each year. **This practice increases the state's long term liabilities by over \$1.6 billion.**

VSTRS OPEB costs are primarily funded by the General Fund (\$35.1 million for FY22) 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	VSTRS
General Fund	\$35,093,844
Other Funds	\$414,832
New Teacher Health Care Employer Charges	\$4,108,428
Employee Group Waiver Plan subsidies	\$2,951,944
Total:	\$42,569,048

General Fund OPEB Costs (\$ million)				
	FY19	FY20	FY21	FY22 (Govrec)
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 (VSTRS OPEB is 0.69% funded as of June 30, 2020) and there is no prefunding policy codified into statute.
- 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.

	FY22 Estimated Net (unfunded) OPEB Liability (millions) – Status quo paygo	Estimated Net OPEB Liability (millions) if prefunded	Change to Net OPEB Liability (millions)
VSERS	\$1,617	\$754.9	\$861.9
VSTRS	\$1,480.7	\$658.8	\$821.9
Total	\$3,097.5	\$1,413.7	\$1,683.8

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, but only cover a small fraction of the cost of this benefit.
- The practice of paying for teacher OPEB out of the VSTRS pension system ended in 2014. The teacher OPEB costs have been paid from the General Fund ever since despite the VSTRS pension normal cost moving to the Education Fund in 2017.
- 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.**

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	<u>8,911,382</u>	<u>1.34%</u>	<u>323,013</u>	<u>0.05%</u>
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	<u>49,528,078</u>	<u>7.47%</u>	<u>40,722,830</u>	<u>6.26%</u>
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	<u>9,329,008</u>	<u>1.41%</u>	<u>335,497</u>	<u>0.05%</u>
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	<u>38,332,816</u>	<u>5.78%</u>	<u>35,657,941</u>	<u>5.48%</u>
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%.

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 2.21% 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 3.00%.

Normal cost = The amount that must be invested each year to have enough money in the future to fund that year's worth of future retirement benefits earned by today's active workforce.

VSTRS pension normal costs are currently funded from Ed Fund because they represent a cost of compensating the currently active workforce.

The OPEB normal cost for FY22 would be \$13.8 million assuming those assets are invested with VPIC at 7%.



Prefunding OPEB

Prefunding is a more fiscally sound approach than paygo. Prefunding takes advantage of compound interest over time to fund future benefits. This reduces the cost to taxpayers in the long term and ensures funds will be available in trust to provide benefits in the future.

Prefunding OPEB will require a plan for funding both the normal cost and the net (unfunded liability).

Normal cost = newly earned future benefits from current workforce
Net (unfunded) liability = previously earned benefits from the workforce of prior years.

Moving to prefund VSTRS OPEB would result in a reduction of the state's net (unfunded) teacher OPEB liability from \$1,480.7 million to \$658.8 million (**a decrease of \$821.9 million**) due to the ability to use a 7% investment rate.

Until both a statutory funding schedule and a commitment to additional appropriations to build up a pool of assets are enacted, the state will be required to continue using the 2.21% rate and would not be able to realize the \$821.9 million liability reduction that it would see if all elements of a prefunding system are implemented. **However, determining a funding strategy for the normal cost (in addition to continuing to fund paygo costs) is an important step toward getting there and begins the process of building up a pool of assets invested at 7% to fund future benefits.**

Questions?

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Thank you!