OPEB OVERVIEW

Vermont Legislative
JOINT FISCAL OFFICE

Chris Rupe

Fiscal Analyst

Joint Fiscal Office

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.**

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	$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%

All data as of end of FY20

OPEB Background

- State employees are entitled to continue their health coverage into retirement (3 V.S.A. Ch.21) . A Retired Employees' Committee on Insurance is created in statute to review and recommend changes to the Secretary of Administration on retiree health benefits.

- 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.

- VSTRS provides postemployment healthcare benefits to eligible VSTRS retirees. VSTRS Trustees have the statutory authority (16 V.S.A. §1942) to enter into insurance arrangements, amend the benefit provisions of the plan and establish maximum obligations of plan members to contribute to 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 .

- **OPEB is not the same as pensions!** Contribution/subsidy rates are codified into statute but there are generally fewer legal restrictions on making changes to the OPEB benefit structure.

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 pension group and 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

VSERS Group C, D, and Old F have 80% subsidy without tiers.

OPEB Costs

OPEB is funded on a paygo basis.

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

VSTRS employer 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 (post-July 2015) help to offset these costs.

FY22 Budget	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.

- The total aggregate OPEB accrued liabilities do not presently directly impact the state budget. However, the actual cost of paying the current-year premiums <u>does</u> impact the budget 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. As of 6/30/20:
  - 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.

OPEB History

- Previous OPEB efforts have often focused on ways to reduce liabilities/costs, such as changing the benefit structure for certain 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 for more newly hired teachers were implemented in FY19.
- 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

The lack of pre-funding OPEB liabilities, in and of itself, is responsible for **$1.68 billion** of Vermont's unfunded OPEB liabilities.

- With prefunding, the state can calculate its unfunded liabilities by applying an assumed rate of return 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 prior.

- Federal monetary policy has driven down interest rates in recent years. As interest rates decline, the unfunded OPEB liabilities increase. **The impact of declining interest rates increased the unfunded OPEB liabilities by $488 million in 2020 just from this factor:**

    - VSERS: $256 million increase
    - VSTRS: $232 million increase

Numbers as of 6/30/20

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, liabilities would have decreased below expected levels from FY19-20 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.

($ million)	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.

- Either an ADEC (normal cost + unfunded liability amortization payment) or alternative funding schedule could be pursued. For example:

    - 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).

- Prefunding would have immediate benefits to the state:

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

Benefits of Prefunding

- If VT began to prefund and established a prefunding policy into statute, the state's liabilities would be reduced by approximately **$1.683.8 billion** – mostly due to the ability to use a 7.0% discount rate.

- Prefunding would respond to concerns raised by rating agencies.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Inability to prudently manage the long-term liability burden, in the context of modest growth expectations for the economic base available to support repayment

-Fitch, April 16, 2021

($ million)	FY22 Estimated Net (unfunded) OPEB Liability (millions) – Status quo paygo	Estimated Net OPEB Liability (millions) if prefunded	Change to Net OPEB Liability (millions)
VSERS	$1,616.8	$754.9	$861.9
VSTRS	$1,480.7	$658.8	$821.9
Total	**$3,097.5**	**$1,413.7**	**$1,683.8**

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 <u>both</u> ongoing appropriations in excess of the paygo amount <u>and</u> a funding policy codified in statute that commits the state to making those higher appropriations.

- The state OPEB plan 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. Current law deposits 50% of unreserved/undesignated General Fund balance into the state OPEB trust. Any excess reserves or other one-time revenue sources could potentially be used as additional sources of prefunding.

- Prefunding will require the Legislature to adopt (and adhere to) a statutory funding plan to pay the ongoing premium cost <u>PLUS</u> some amount above and beyond that cost toward prefunding.
  - 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