Preliminary Fiscal Estimates – Pension Task Force Final Recommendations

Chris Rupe, JFO – January 11, 2022

Below is a *preliminary estimate* of the fiscal impact of the final recommendations of the Pension Task Force. Estimates are based on prior actuarial analysis performed by the State's actuary, Segal, along with JFO estimates. Note that numbers are preliminary pending additional actuarial analysis and may vary due to timing and actuarial gains/losses.

VSERS Recommendations

Category	**Est. Impact to Unfunded Liabilities**
Pension Benefit Recommendations	$58.4 million
One-Time Pension Contributions	$75.0 million
Prefunding OPEB	$891.3 million
Total Estimated Unfunded Liability Reduction	**$1,024.7 million**

<u>Pension Recommendations:</u>
With respect to the pension benefits for VSERS members, the Task Force recommends:

- Make no changes to the pension benefits of current retirees, beneficiaries, or terminated vested members.
- In FY 2022, making a one-time payment of $75 million in General Funds towards the unfunded liability using 50 percent of the $150 million reserved in General Funds in the FY 2021 Budget.
- Modifying the COLA structure by:
    - Amending the minimum and maximum amounts of any decreases and increases used to determine the net percentage change in the Consumer Price Index from the current one percent minimum and five percent maximum to zero percent minimum and four percent maximum for Groups C and F; and
    - Requiring a member to receive retirement benefits for at least 24 months prior to receiving a COLA, an increase from the current 12 months.
    - COLA changes shall not apply to active members who are eligible for normal (unreduced) retirement as of July 1, 2022.
- Beginning in FY 2023, increase the contribution rates of active employees as follows:
    - For Group C members, by 0.5 percent per year for three fiscal years, with full phase-in occurring in FY 2025; and

  - For Group F members:
    - No change for members with base salaries below the 25th percentile.
    - 0.5 percent per year for three fiscal years, for members with base salaries between the 25th and up to the 50th percentile.
    - 0.5 percent per year for four fiscal years for members with base salaries above the 50th percentile and up to the 75th percentile.
    - 0.5 percent per year for five fiscal years for members with base salaries above the 75th percentile.

- Increasing the Group C mandatory retirement age from 55 to 57 years of age.

- For Group C members, increase the maximum benefit cap by 1.5 percent of average final compensation for each year worked beyond reaching the later of age 50 or 20 years of benefit service, applied prospectively to service actually worked after July 1, 2022.

- Beginning in FY 2024, codifying the State's intent to annually fund an additional payment to the ADEC using monies saved from a reduction on the required annual unfunded liability amortization payment. The "plus" payment will grow to $15 million in FY 2026 and remain at that level until the fund reaches 90% funded.

- Amending the General Fund year end surplus construct to reallocate 25 percent to VSERS pension underfunding.

- By April 15, 2022, directing the State Treasurer and the VSERS Board of Trustees to recommend to the General Assembly:
  - a plan for creating a new pension benefit group for DOC employees that is actuarially neutral to the pension system and results in no additional employer pension costs; and
  - 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.

With respect to Group D members, the Task Force recommends:

- Beginning in FY 2023, increase the contribution rates of active judges as follows:
  - No change for members with base salaries below the 25th percentile.
  - 0.5 percent per year for three fiscal years, for members with base salaries between the 25th and up to the 50th percentile.
  - 0.5 percent per year for four fiscal years for members with base salaries above the 50th percentile and up to the 75th percentile.
  - 0.5 percent per year for five fiscal years for members with base salaries above the 75th percentile.
- Making the following pension benefit changes to all active members except those that have five years or more of service and are either: (1) within five years of 62 years of age or 62 years of age and older, or (2) have 15 years or more of service ("exempt judges"):
  - Amend the calculation for final salary to the average salary for the final two years of employment for active members who retire after July 1, 2022 and who are not exempt as defined above.

  - Beginning in FY 2023, reduce the maximum pension benefit from 100 percent to 80 percent of salary for all active judges not exempt as defined above.
  - Raise the retirement age to 65 years or older for any new judges appointed or elected July 1, 2022 or after.
  - For any judge appointed or elected July 1, 2022 or after, modify the COLA structure to apply the maximum amount on any increases used to determine the net percentage payable to the first $75,000 of benefit paid. For amounts $75,000 or more, the COLA is set at 50 percent of the net percentage change in the CPI index.
  - Applies the COLA payments to members who have received a retirement benefit for at least twenty-four (24) months and makes no changes to the current COLA for judges who are appointed or elected on or before June 30, 2022.

<u>OPEB Recommendations:</u>
With respect to health care benefits for State employee retirees, the Task Force recommends:

- Prefunding OPEB benefits by building on the $52.4 million one-time appropriation into the State Employees' Postemployment Benefits Trust Fund from the FY 2021 general fund surplus and enacting a prefunding schedule in statute.

- Continuing to apply current "pay go" amount for retired employees into the State Employees' Postemployment Benefits Trust Fund.

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).

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.
$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 ($15M by FY2026) 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.

VSTRS Recommendations

Category	Est. Impact to Unfunded Liabilities
Pension Benefit Recommendations	$34.9 million
One-Time Pension Contributions	$125.0 million
Prefunding OPEB	$836.8 million
Total Estimated Unfunded Liability Reduction	**$996.7 million**

<u>Pension Recommendations:</u>

With respect to the pension benefits for VSERS members, the Task Force recommends:

- Make no changes to the pension benefits of current retirees, beneficiaries, or terminated vested members.

- In FY 2022, making a one-time payment of $75 million in General Funds towards the unfunded liability using 50 percent of the $150 million reserved in General Funds in the FY 2021 Budget, plus an additional $50 million in General Funds towards the unfunded liability.

- Beginning July 1, 2022, modifying the COLA structure by:

    - amending the minimum and maximum amounts of any decreases and increases used to determine the net percentage change in the Consumer Price Index from the current one percent minimum and five percent maximum to zero percent minimum and four percent maximum;
    - requiring a member to be receiving a retirement benefit for at least 24 months prior to receiving a COLA, an increase from the current 12-month requirement;
    - increase the 50 percent of CPI COLA formula by 7.5 percent each year once the pension system reaches an 80 percent funded status, provided that the increase does not result in the fund projected to fall below the 80 percent funded status. If the increase would result in a drop below 80 percent, then the formula is paused at the levels in place at the time pending re-evaluation in the subsequent year; and
    - applies any increases to the COLA to members who leave active service on or after June 30, 2023.

- Beginning in FY 2023, increases the contribution rates for all active members over a three-year period according to the following marginal rate schedule:

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.

- Beginning in FY 2024, codifying the State's intent to annually fund an additional payment to the ADEC using monies saved from a reduction on the required annual unfunded liability amortization payment. The "plus" payment will grow to $15 million in FY 2026 and remain at that level until the fund reaches 90% funded.

- Amend the General Fund year end surplus construct to reallocate 25 percent to VSTRS pension underfunding.

<u>OPEB Recommendations:</u>
With respect to other postemployment benefits for retired teachers, the Task Force recommends:

- Using $13.3 million of Education Fund money currently in reserve to begin prefunding other postemployment benefits by making a one-time appropriation into the Retired Teachers' Health and Medical Benefits Fund.

- Enacting a prefunding schedule into statute that charges the OPEB normal cost to the Education Fund.

- Continuing to apply current "pay go" for retired employees into the Retired Teachers' Health and Medical Benefits 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.

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.
$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.

Summary of Pension Agreement Fiscal Impacts on Education Fund (in millions)					
	FY22	**FY23**	**FY24**	**FY25**	**FY26**
Teacher Retiree Healthcare Fund (New to Ed Fund)					
One-Time Funding For Volatility	$13.3				
Normal Cost Teachers OPEB		$15.1	$15.6	$16.0	$16.5
Teacher Retiree Pension Fund (Normal Cost Already in Ed Fund)					
Higher Teacher Contribution Savings		-$6.2	-$8.3	-$10.3	-$11.1
Combined COLA Savings		-$1.6	-$1.6	-$1.7	-$1.7
Total Net Ed Fund Impact	**$13.3**	**$7.3**	**$5.6**	**$4.0**	**$3.7**

Note: Numbers are preliminary, may change with acturial review