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Joint Fiscal Office
1 Baldwin Street • Montpelier, VT 05633-5701 • (802) 828-2295 • https://ljfo.vermont.gov

Fiscal Note

March 16, 2022 By Stephanie Barrett and Chris Rupe

S.286 – An act relating to amending various public pension and other postemployment benefits

As amended by the Senate Committee on Appropriations – Draft 1.1

https://legislature.vermont.gov/Documents/2022/Docs/BILLS/S-0280/S-0280%20As%20Introduced.pdf

Bill Summary

This legislation implements the final recommendations of the Pension Benefits, Design, and Funding Task Force created by the Legislature in Act 75 (2021). Based on preliminary actuarial estimates, **the bill is expected to reduce Vermont's long-term unfunded retirement liabilities for state employees and teachers by approximately $2 billion** by prefunding other post-employment benefits, modifying the pension benefit structure, and making additional State and employee contributions into the retirement systems.

This bill contains a **$200 million one-time General Fund appropriation in FY 2022** to the pension systems to pay down unfunded liabilities – $75 million to the Vermont State Employees' Retirement System (VSERS) and $125 million to the Vermont State Teachers' Retirement System (VSTRS). The bill also contains **a $13.3 million one-time Education Fund appropriation in FY 2022** to the Retired Teachers' Health and Medical Benefits Fund to begin prefunding health care benefits for retired teachers.

Overview of Legislation

Pension Provisions

S.286 includes the following pension-related provisions, which are proposed to take effect for the VSERS and VSTRS retirement systems beginning in FY 2023 (unless noted otherwise):

- **No changes to the benefits of current retirees and beneficiaries.**
- **State makes a one-time $200 million payment toward unfunded pension liabilities**. The payment would be made in FY 2022 from reserved general funds and allocated $75 million to VSERS and $125 million to VSTRS. This payment is expected to immediately reduce the unfunded liabilities and improve the funded ratios. It is also expected to save interest costs and reduce the actuarially determined employer contributions (ADEC) in the future, with relative savings beginning in FY 2024 at approximately $19.5 million in total across both systems.
- **Higher employee contribution rates for active members of both systems**, phased in over a 3- to 5- year period. By full phase-in, the higher contribution rates are expected to yield approximately $14 million (VSERS in FY 2027) and $10.3 million (VSTRS in FY 2025) of revenue, which would reduce the respective employer normal costs (which are paid through the ADEC) by a commensurate amount.

Note that actuarial estimates are based on the assumptions in place at the time of the analysis. Actual fiscal impacts are subject to vary from preliminary actuarial estimates due to differences in timing, pension plan experience, future changes to long term assumptions, membership census, and demographic behavior. Estimates are preliminary and subject to revision from additional actuarial analysis.

- **Modifications to the Cost-of-Living-Adjustment (COLA) formula for all employee groups, plus changes to other terms of the pension benefit for VSERS Groups C and D**. The proposed changes are expected to yield approximately $58 million of unfunded liability reduction and $8.7 million of relative ADEC savings for VSERS, and $35 million of unfunded liability reduction and $4.8 million of relative ADEC savings for VSTRS.
- **State commits to ongoing additional payments toward the unfunded liability**. Beginning in FY 2024, an additional payment above the actuarially recommended amount would be included in the annual appropriation requests for the pension systems. The additional payment would increase to a maximum of $15 million per system by FY 2026 and remain in place until the respective systems reach 90 percent funded. This provision effectively reinvests a portion of the expected future cost savings from the $200 million one-time payment and pension modifications into further paying down the accrued unfunded pension liabilities.

Other Post-Employment Benefits (OPEB)

Sections 6, 12, and 13 contain language to prefund health care benefits (OPEB) for retired State employees and teachers. Currently, benefits for today's retirees are funded on a pay-as-you-go basis with minimal prefunding. By prefunding, the State will realize a reduction of its unfunded liabilities by approximately $891.3 million for VSERS and $836.8 million for VSTRS due to the ability to discount liabilities using the 7.0% rate of return adopted by the Vermont Pension Investment Commission (VPIC) for the pension investments rather than the lower 2.2% rate that must be used in the absence of prefunding per government accounting rules. Prefunding will result in long-term savings from the ability to take advantage of compound investment gains over time to fund future benefits, but it will require higher expenses in the near term. In FY 2023, $15.1 million is needed from the Education Fund to begin funding the OPEB normal cost, and approximately $15 million of General Fund is needed across both systems to transition to prefunding. Other provisions of the bill, however, such as the proposed increases to employee contribution rates, COLA modifications, and the impact of one-time State contributions, are expected to result in future recurring savings in pension costs that will offset a substantial portion of the added fiscal impact from prefunding OPEB.

Year-End Surplus Construct

Beginning with the close of FY 2023, Section 17 amends the existing statutory construct in 32 V.S.A. § 308c(a)(3) that dedicates 50 percent of unreserved and undesignated end of year General Fund surpluses to the Vermont State Employees' Postemployment Benefits Trust Fund (VSERS OPEB). The bill would instead direct any such surpluses equally to the VSERS and VSTRS pension systems. If surpluses exist at the close of the year this will further strengthen the fiscal position of those systems. It is not possible to accurately estimate the fiscal impact of this provision since the amount of unreserved and undesignated surpluses are subject to other spending decisions and actual end-of-year revenue collections which vary from year to year. However, if additional contributions are made into the pension systems under this provision, it will have a positive impact on the funded ratios and size of future required employer contributions.

Other Provisions

Sections 7, 8, 9, and 15 propose clarifying amendments to several provisions enacted in Act 75 (2021) pertaining to the required frequency of experience studies and asset and liability studies for the three statewide pension systems. Act 75 stipulated that the Vermont Pension Investment Commission (VPIC) shall perform asset and liability studies on a three-year basis beginning on July 1, 2022. Act 75 further stipulated that the three Retirement Boards perform experience studies at least once every three years after the effective date of the Act–the prior requirement was at least once every five years. The language in these sections clarifies, where appropriate, that the three-year cycle is defined as three *fiscal years* of actuarial data, not the three-year anniversary of the completion date of the most recent studies. The language also provides the VPIC and Retirement Boards with the option to delay the upcoming studies by a year in order to include FY 2023 data in the studies. The most recently completed experience studies were based on the FY 2019 valuations. Absent

this change, the next experience studies would cover data for the three fiscal years from FY 2020 through FY 2022 and omit many impacts from the proposed changes contained in this bill, which take effect in FY 2023. The Vermont Municipal Employees' Retirement System (VMERS) is outside the scope of the remainder of the bill, but this specific change is proposed to apply to that system for the administrative convenience of having all three pension systems complete experience studies and review actuarial assumptions on the same schedule.

Modifications to the State Employees' Retirement System (VSERS)

Proposed Pension Benefit Changes

S.286 proposes numerous modifications to the pension benefit structure for VSERS active members *(see Table 1)*. No proposed changes would impact current retirees or beneficiaries. Certain proposed changes would not apply to active members who are at or approaching eligibility for normal or unreduced retirement as of the effective date of the changes (July 1, 2022).

Preliminary actuarial analysis commissioned for the Pension Task Force expects these proposed changes will reduce the State's actuarially determined employer contribution (ADEC) by approximately $8.7 million and the VSERS unfunded liability by approximately $58 million. These impacts come primarily from the proposed changes to the COLA benefit, which are expected to lead to a change in the long-term actuarial assumptions used to calculate the normal cost and accrued liabilities. Reductions in the ADEC accrue to the funds of State government in proportion to those funds' shares of the active payroll – approximately 40% typically falls to the General Fund, with the rest charged to federal and special funds.

Table 1: **VSERS Current and Proposed Pension Provisions**

	Current	Proposed	Comments	Bill Sec.
Group C – Law Enforcement/Public Safety (439 active members – FY 2021)				
Unreduced early retirement	Age 50 with at least 20 years of service (whichever is later)	No change	Most Group C members retire under unreduced early retirement at age 50 with at least 20 years of service. No change is proposed.	
Mandatory normal retirement	Age 55 with at least 5 years of service, or completion of 30 years of service (whichever is earlier)	Age 57 with at least 5 years of service, or completion of 30 years of service (whichever is earlier)	The mandatory normal retirement age is proposed to increase from age 55 to 57. This recommendation will not change the current age 55 normal retirement eligibility or require any members to work until age 57 if they are otherwise eligible to retire sooner.	Sec. 3
Max Benefit Payable	50% of Average Final Compensation	50% of Average Final Compensation, plus 1.5% for each year of continuous service worked after 7/1/22 after reaching the later of Age 50 or 20 years of service	Proposed to incentivize members to voluntarily work beyond the age at which they are eligible to retire with an unreduced benefit (age 50 with at least 20 years of service). As of FY 2021, only 12 of the 439 active Group C members (2.7%) remained in service beyond the age at which they are eligible for unreduced early retirement. Encouraging additional members to retire at later ages than they otherwise would is expected to result in actuarial savings.	Sec. 3
COLA	Member must receive a retirement benefit for at least 12 months before receiving a COLA	Member must receive a retirement benefit for at least 24 months before receiving a COLA	Proposed change would only apply to active members who become eligible for normal or unreduced early retirement on or after 7/1/22.	Sec. 4
COLA	Net percentage change in the CPI used to calculate the COLA has a 1% minimum, 5% maximum	Net percentage change in the CPI used to calculate the COLA has a 4% maximum	Proposed change would only apply to active members who become eligible for normal or unreduced early retirement on or after 7/1/22.	Sec. 4
Group D – Judicial (51 active members – FY 2021)				
Average Final Compensation	Final salary at retirement	Average of 2 highest consecutive years	Proposed change would not apply to active members who are age 57+ with at least 5 years of service, or to members with 15+ years of service at any age, as of 6/30/2022.	Sec. 2

Unreduced normal retirement	Age 62 with at least 5 years of service	For members first appointed on or after 7/1/2022, age 65 with at least 5 years of service	Proposed change would increase normal retirement age from 62 to 65 for new hires. Group D members are typically hired at, and work to, later ages than other groups. As of FY 2021 only 22 of the 51 active Group D members (43.1%) were younger than age 60, and 29 of the 51 active Group D members (56.9%) were at least age 60.	Sec. 2
Max Benefit Payable	100% of Final Salary	80% of Average Final Compensation (2 highest consecutive years)	Proposed change would not apply to active members who are age 57+ with at least 5 years of service, or to members with 15+ years of service at any age, as of 6/30/2022.	Sec. 3
COLA	Member must receive a retirement benefit for at least 12 months before receiving a COLA	Member must receive a retirement benefit for at least 24 months before receiving a COLA	Proposed change would only apply to active members who are appointed or elected on or after 7/1/22.	Sec. 4
COLA	Full COLA (100% of net CPI change) on full amount of retirement benefit paid.	Full COLA (100% of net CPI change) on first $75,000 of retirement benefit paid. Reduced COLA (50% of net CPI change) on benefit paid above $75,000.	Proposed change would only apply to active members hired on or after 7/1/22.	Sec. 4
Group F – General Public Employees (7,701 active members – FY 2021)				
COLA	Member must receive a retirement benefit for at least 12 months before receiving a COLA	Member must receive a retirement benefit for at least 24 months before receiving a COLA	Proposed change would only apply to active members who are eligible for normal or unreduced early retirement on or after 7/1/22.	Sec. 4
COLA	Net percentage change in the CPI used to calculate the COLA has a 1% minimum, 5% maximum	Net percentage change in the CPI used to calculate the COLA has a 4% maximum	Proposed change would only apply to active members who become eligible for normal or unreduced early retirement on or after 7/1/22.	Sec. 4

Proposed Employee Contribution Rates

Section 5 proposes numerous modifications to the member contribution rates paid by active employees, beginning in FY 2023 *(see Table 2)*. Employee contributions are made on a pre-tax basis and revenue is credited toward the normal cost of the member's future pension benefits (not toward the unfunded liability). Additional revenue raised through employee contributions reduces employer pension expenses (the ADEC) by paying a greater share of the total normal cost that would otherwise fall to the employer to pay.

Table 2: **VSERS Current and Proposed Pension Employee Contribution Rates**

	Current	Proposed	Comments	Bill Sec.
Group C	8.53%	0.5% increase per year for 3 years	Beginning in FY 2023, for all active members. The contribution rate would be 10.05% at full phase-in (FY 2025).	Sec. 5
Group D	6.65%	Base salary <25th percentile: No change. Base salary 25th — 50th percentile: 0.5% increase per year for 3 years. Base salary 50th— 75th percentile: 0.5% increase per year for 4 years. Base salary 75th + percentile: 0.5% increase per year for 5 years.	Beginning in FY 2023, for all active members. The proposed rates mirror those proposed for Group F. 5-year phase-in of contribution increases, by salary quartile. A member's contribution rate would be based on the quartile their base hourly rate of pay falls within, with the rate charged to every dollar earned by the member each fiscal year. Quartiles calculated annually. By full phase-in (FY 2027), contribution rates would be: 0—25th percentile: 6.65% 25th— 50th percentile: 8.15% 50th— 75th percentile: 8.65% 75th+ percentile: 9.15%	Sec. 5

Group F	6.65%	Base salary <25th percentile: No change. Base salary 25th — 50th percentile: 0.5% increase per year for 3 years. Base salary 50th— 75th percentile: 0.5% increase per year for 4 years. Base salary 75th + percentile: 0.5% increase per year for 5 years.	Beginning in FY 2023, for all active members. The proposed rates mirror those proposed for Group D. 5-year phase-in of contribution increases, by salary quartile. A member's contribution rate would be based on the quartile their base hourly rate of pay falls within, with the rate charged to every dollar earned by the member each fiscal year. Quartiles calculated annually. By full phase-in (FY 2027), contribution rates would be: 0—25th percentile: 6.65% 25th— 50th percentile: 8.15% 50th— 75th percentile: 8.65% 75th+ percentile: 9.15%	Sec. 5

Preliminary actuarial analysis commissioned for the Pension Task Force expects these proposed changes will generate approximately $2.8 million of revenue in FY 2023, growing to approximately $14 million by FY 2027 when the proposed rates are fully phased in across all groups *(see Table 3)*. Actual amounts may fluctuate from estimates, however, due to timing factors and fluctuations in the census and payroll characteristics of the active workforce.

After full phase-in of the proposed rate structure (expected to occur in FY 2025 for Group C, and FY 2027 for Groups D and F), overall payroll growth is expected to increase at a long-term annual growth rate of 3.5%. Revenue from employee contributions, in turn, would expect to increase at a similar pace with the size of the overall payroll when all else is equal.

Table 3: **Estimated Additional Revenue from Proposed VSERS Employee Contributions**
($ millions)

Fiscal Year	Group C	Group F
FY 2023	0.2	2.5
FY 2024	0.4	5.3
FY 2025	0.6	8.4
FY 2026	0.6	11.1
FY 2027	0.6	13.3

Note: Group D is not reflected in these estimates but due to the small size of the group the additional expected revenue will likely be within a rounding error of $0.1 million annually.

Modifications to the State Teachers' Retirement System (VSTRS)

Proposed Pension Benefit Changes

Section 11 proposes several modifications to the pension benefit structure for VSTRS active members *(see Table 4 on the following page)*. Similar to the recommendations made for VSERS, no proposed changes would impact current retirees or beneficiaries. The proposed changes to the COLA would not apply to active members who are eligible for normal or unreduced retirement as of June 30, 2022).

Preliminary actuarial analysis commissioned for the Pension Task Force expects these proposed changes will reduce the State's actuarially determined employer contribution (ADEC) by approximately $4.8 million and the VSTRS unfunded liability by approximately $34.9 million. These impacts come from the proposed changes to the COLA benefit, which are expected to lead to a change in the long-term actuarial assumptions used to calculate the normal cost and accrued liabilities. Reductions in the VSTRS ADEC accrue primarily to two funds of State government – savings from reducing the normal cost (approximately $1.6 million) primarily accrue to the Education Fund, and savings from reducing the unfunded liabilities (approximately $3.2 million) primarily accrue to the General Fund. A small portion of savings will also accrue to Local Education Agencies that make contributions to both the normal cost and unfunded liability on their federally funded staff.

Additionally, Section 11 proposes a path that allows for the COLA benefit formula to be increased in the future when the VSTRS pension system is at least 80 percent funded for members who leave active service on or after June 30, 2023. Currently, VSTRS Group C members receive a COLA in retirement that is calculated at 50 percent of the net percentage change in the CPI. The intent behind this section is to provide a path to eventually increase the COLA formula for members who paid at least one year (approximately) of the increased recommended employee contributions (see below) by 7.5 percent per year once the system reaches 80 percent funded, provided that doing so would not result in the fund falling below 80 percent funded. If the 7.5 percent increase in the COLA formula would cause the pension fund to drop below 80 percent funded, the formula would be paused at the levels in place at the time and re-evaluated in the subsequent year. This recommendation has not been costed out by actuaries to date. As of the FY 2021 actuarial valuation, which does not reflect any of the proposed changes in this bill, the VSTRS system is expected to reach 80% funded in approximately FY 2033.

Table 4: **VSTRS Current and Proposed Pension Provisions**

	Current	Proposed	Comments	Bill Sec.
Group C – All Active Members Hired After 7/1/90 Plus Former Group B Members as of 7/1/90				
COLA	Member must receive a retirement benefit for at least 12 months before receiving a COLA	Member must receive a retirement benefit for at least 24 months before receiving a COLA	Proposed change would only apply to members who are active on or after 7/1/22.	Sec. 11
COLA	Net percentage change in the CPI used to calculate the COLA has a 1% minimum, 5% maximum	Net percentage change in the CPI used to calculate the COLA has a 0% minimum, 4% maximum.	Proposed change would only apply to members who are active on or after 7/1/22.	Sec. 11

Proposed Employee Contribution Rates

Section 10 proposes modifications to the member contribution rates paid by active VSTRS employees, beginning on July 1, 2022 *(see Table 5)*. Employee contributions are made on a pre-tax basis and revenue is credited toward the normal cost of the member's future pension benefits, not toward the unfunded liability. Additional revenue raised through employee contributions reduces employer pension expenses (the ADEC) by paying a greater share of the total normal cost that would otherwise fall to the employer to pay. Most of the savings from higher employee contributions would accrue to the Education Fund.

Table 5: **VSTRS Current and Proposed Pension Employee Contribution Rates**

Current	Proposed			
	Base Salary Level	**FY 2023**	**FY 2024**	**FY 2025**
Members At Least Age 57 or With At Least 25 Years of Service On 6/30/2010 pay 5.0%	< $40,000	6.0%	6.25%	6.25%
	$40,000.01—$60,000	6.50%	6.75%	6.75%
Members Less Than Age 57 or With Less Than 25 Years of Service on 6/30/2010 pay 6.0%.	$60,000.01 — $80,000	6.75%	7.00%	7.50%
	$80,000.01—$100,000	7.00%	7.50%	8.25%
	$100,000.01+	7.25%	8.00%	9.00%
Add'l Est. Revenue ($ million)		**6.2**	**8.7**	**10.3**

The Pension Task Force recommended moving to a progressive contribution structure for VSTRS members, beginning in FY 2023. A rate structure with five fixed income brackets would be phased in over a three-year period. The member's effective contribution rate would be determined annually by the bracket that their base annual contract salary falls within, with that effective rate charged on every dollar earned by the member over the course of the year. Preliminary estimates by JFO based on active payroll data suggest that approximately $10.3 million of additional revenue could be generated by full phase-in of the progressive rate structure in FY 2025, which will reduce the Education Fund's contribution. Overall payroll growth is expected to increase at a long-term annual growth rate of 3.0%. Revenue from employee contributions, in turn, would expect to increase at a similar pace

when all else is equal. However, actual revenues may fluctuate from estimates due to fluctuations in timing and the census and payroll characteristics of the active workforce.

Additional State Pension Contributions

One-Time Contributions

Section 15 contains $200 million of one-time General Fund contributions to the two pension systems to pay down the respective unfunded liabilities — $75 million to VSERS and $125 million to VSTRS — in recognition of the fact that the VSTRS system has a significantly larger unfunded liability. Act 74 (2021) reserved $150 million of FY 2021 general funds for pension funding initiatives, which Section 15 unreserves and appropriates equally to both systems. Section 15 also appropriates an additional $50 million from FY 2022 general funds to the VSTRS system.

These one-time pension contributions would be made in FY 2022 and result in future recurring employer ADEC savings beginning two years in the future (FY 2024). Although the actual fiscal impact of these contributions will be determined by future actuarial valuations in conjunction with other experience factors, preliminary analysis commissioned by the Task Force estimates a Year 1 (FY 2024) impact of approximately $7.3 million (VSERS) and $12.2 million (VSTRS) of relative ADEC savings from one-time contributions of similar magnitudes. For VSERS, these savings would accrue to the funds of State government in proportion to their shares of the active payroll. For VSTRS, these savings would primarily accrue to the General Fund with a small portion accruing to Local Education Agencies on their federally funded staff.

Recurring Additional State Contributions to the Pensions Systems

Sections 5 and 10 propose ongoing commitments of State funds to further accelerate the pay-down of the unfunded pension liabilities. Beginning in FY 2024, the first year of anticipated ADEC savings from the impact of the one-time contributions, the State would make supplemental contributions above the actuarially recommended amount and effectively redirect the savings into further paying down the unfunded liabilities. These sections propose additional amounts to each system of $9 million in FY 2024, $12 million in FY 2025, and $15 million in FY 2026. The amounts would then remain at $15 million until the respective pension system reaches 90 percent funded. According to the FY 2021 actuarial valuations, which do not reflect any of the impacts of the proposed changes contained in this bill, the systems are expected to reach 90 percent funded in a status quo situation in FY 2034 (VSERS) and FY 2036 (VSTRS), respectively.

Section 5 proposes that the annual VSERS funding recommendation made by the Retirement Board shall reflect the actuarially determined employer contribution plus these additional payments toward the unfunded liability, with the total cost reflected in the annual percentage assessed to payroll across all the various employing agencies/departments and funds of state government. Section 10 proposes a similar requirement of the VSTRS Retirement Board to reflect the additional payment in its annual funding request; however, VSTRS employer pension costs are paid through a direct appropriation in the annual appropriations bill. These commitments would be subject to appropriations by future legislatures.

Like one-time contributions, recurring contributions in excess of the actuarially recommended amount are expected to have positive impacts; improving the systems' funded ratios, accelerating the pay down of the unfunded liability, and resulting in future ADEC savings. While the Pension Task Force commissioned actuarial analysis on similar recurring revenue scenarios, the impacts of this specific proposal have not been costed out by the actuaries to date.

Prefunding Other Post-Employment Benefits (OPEB)

Prefunding retirement benefits like pensions and OPEB involves setting aside funds over the course of an active member's career, investing those assets, and using the compound investment gains to partially fund the

cost of future benefits. The initial costs of moving to prefunding are higher than the current "paygo" system of paying the benefits for current retirees as they become due. However, prefunding itself substantially lowers the State's unfunded retirement liabilities and is more cost efficient over time since investment gains offset expenses to taxpayers in the future.

Prefunding requires the State to enact a statutory funding policy that meets actuarial review, then commit to future contributions above the paygo amount to build up a pool of surplus assets to be invested over time. At the end of the amortization period, the systems would be projected to have enough assets to fund the cost of benefits to future retirees, provided that the normal cost continues to be fully funded and all actuarial assumptions are met. With a statutory prefunding policy enacted, the assets of the two OPEB systems can be invested with VPIC with an assumed long-term rate of return that is currently 7.0 percent. By using a 7.0 percent rate of return to discount liabilities, rather than the 2.20 — 2.41 percent rates tied to the 20-year AA municipal bond rate that accounting rules require paygo systems to use, the unfunded OPEB liabilities would be reduced by approximately $1.728 billion by the end of FY 2023 *(see Table 6)*.

Table 6: **Estimated Impact of Prefunding OPEB**

	State Employee OPEB			Teacher OPEB		
	FY 2023 – Status Quo Paygo	FY 2023 – Prefunding	Change	FY 2023 – Status Quo Paygo	FY 2023 – Prefunding	Change
1. Rate of Return	2.41%	7.00%		2.20%	7.00%	
2. Actuarial Accrued Liability	$1,787,402,771	$901,630,521	($885,772,250)	$1,519,502,091	$683,414,665	($836,087,426)
3. Fund Assets	$123,166.267	$128,686,560	$5,520,293	$14,955,429	$15,657,836	$702,407
4. Unfunded Liability (2-3)	$1,664,236,267	$772,943,961	($891,292,306)	$1,504,546,662	$667,756,829	($836,789,833)
5. Normal Cost	$66,216,417	$20,897,140	($45,319,277)	$56,584,557	$15,104,597	($41,479,960)
6. Amortization of Unfunded Liability	$55,898,305	$43,680,845	($12,217,460)	$52,403,565	$39,709,031	($12,694,534)
7. Total ADEC (5+6)	$122,114,722*	$64,577,985	($57,536,737)	$108,988,122*	$54,813,628	($54,174,494)

(*) Under Status Quo Paygo, the OPEB ADEC is not fully funded. Instead, only the paygo cost of providing benefits to current retirees is appropriated. The proposed prefunding policy will require the ADEC (both the normal cost and the unfunded liability amortization payment) to be fully funded in future years.

Source: FY 2021 GASB 74 Valuations

Sections 6 and 12 contain the statutory funding policies required to prefund the OPEB benefits and fully fund the net unfunded liabilities by FY 2048. Like pensions, the OPEB prefunding is proposed to reflect an employer normal cost contribution to fund the future benefits of today's active members, plus an amortization payment toward the unfunded liabilities already earned by the active and retired workforce. These annual payments are made into a benefits fund, which pays the cost of benefits for current retirees from the proceeds of those contributions and the compound investment gains earned on those assets over time.

Like how pensions are funded, Section 6 proposes that the VSERS OPEB contribution amount be recommended annually by the Retirement Board and paid from an assessment charged to the funds of State government in proportion to their share of the active payroll. Typically, approximately 40 percent of these costs are paid from the General Fund, with federal and special funds paying the remainder. Likewise, Sections 12 and 13 propose to mirror the VSTRS pension funding structure by paying the OPEB normal cost from the Education Fund and the unfunded liability amortization payment (net of contributions from LEAs) from the General Fund. Furthermore, Section 15 unreserves $14 million of FY 2021 Education Fund dollars that were reserved in Act 74 (2021) and appropriates $13.3 million of those funds to the Retired Teachers' Health

and Medical Benefits Fund (teacher OPEB). This one-time appropriation will help seed the initial stages of prefunding these benefits while hedging against short-term volatility in investment performance, premium costs, plan experience, and other uncertainties. The VSERS OPEB fund, which received $52.4 million from unreserved, undesignated General Fund surplus in FY 2021 per 32 V.S.A. § 308c(a)(3), has sufficient funding to begin prefunding without the need for additional initial appropriations for this purpose. Beginning in FY 2023:

- Prefunding VSERS OPEB is expected to have an increased cost of approximately $22.2 million to all the funds of State government in proportion to their shares of the active payroll. Moving to prefunding would reduce the VSERS OPEB unfunded liabilities by approximately $891.3 million.

- Prefunding VSTRS OPEB is expected to have an increased cost of approximately $15.1 million to the Education Fund and $5.5 million to the General Fund. Moving to prefunding would reduce the VSTRS OPEB unfunded liabilities by approximately $836.8 million.

Summary Chart – Preliminary Estimates of Fiscal Impacts by Fund

Table 7 summarizes the preliminary expected relative fiscal impacts of the various provisions contained in S.286, and *Table 8* on the following page summarizes the additional state investments and impacts to the unfunded retirement liabilities by system. At the time of publication, the FY 2023 pension funding levels recommended by the pension boards of trustees and included in the Governor's Recommended budget reflect status quo – not the impacts of these proposed modifications. This is due to timing reasons — the funding recommendation is typically informed by the actuarial valuation for the most recently *completed* fiscal year (so the FY 2021 valuation informed the FY 2023 funding recommendation) and the proposed changes contained in S.286 have not yet been enacted. Actuarial analysis that incorporates the proposed changes, which would take effect beginning in FY 2023, would be required for the pension trustees to revise the funding requests for FY 2023.

Table 7: **Preliminary Estimates of Anticipated FY23 Budget Impact of S. 286**
($ millions)

State Employees	FY23		Teachers	FY23	
Current FY23 Budget For Employer Contribution			**Current FY23 Budget For Employer Contribution**		
Pension - Normal and Unfunded Liability	124.2	all funds	Pension - Normal	40.7	Ed Fund
OPEB/Retiree Health Care- PayGo	43.7	all funds	Pension - Unfunded Liability	157.5	GF
Total (payroll assessment funded)	**167.9**	all funds	OPEB/Retiree Health Care- PayGo	29.6	GF
			Total	**227.8**	all funds
S.286 Estimate Budget Need	**FY23**		**S.286 Estimate Budget Need**	**FY23**	
Pension - Normal and Unfunded Liability	112.7	all funds	Pension - Normal	32.9	Ed Fund
OPEB Prefund - Normal and Unfunded Liability	64.6	all funds	Pension - Unfunded Liability	154.3	GF
Total (payroll assessment funded)	**177.3**	all funds	OPEB Prefund - Normal	15.1	Ed Fund
			OPEB Prefund - Unfunded Liability	35.1	GF
			Total	**237.4**	all funds
FY23 Total Budget Impact	**9.4**	GF FY23	**FY23 Budget Impact**		
Address with $10 million onetime GF in FY23, a transition year to help agencies and departments unable to absorb the increase in payroll assessment needed for FY23			Education Fund - OPEB	15.1	
			Education Fund - Pension	-7.8	
			General Fund - OPEB	5.5	
			General Fund - Pension	-3.2	
			Total	**9.6**	

Note that all expected fiscal impacts from these changes should be viewed in relative terms and assume that all actuarial assumptions are met and all else is equal. Other factors may create actuarial gains and losses that offset expected costs/savings from the provisions of the bill.

Table 8: **Summary of Estimated Impacts by System**
($ millions)

	State Employees	Teachers
Current System (FY 2021)		
Pension Unfunded Liabilities	1,064.4	1,950.4
OPEB Unfunded Liabilities	1,473.1	1,275.6
New State Resources		
FY 2022 General Fund - Pension	75.0	125.0
FY 2022 OPEB Prefunding One-Time	52.4 (GF)	13.3 (EF) – FY2022 5.5 (GF) – FY 2023
FY 2023 OPEB Base (all funds)	22.2	15.1 (EF)
Totals	**149.6**	**153.4**
OPEB Unfunded Liability Reduction	**-891.3**	**-836.8**
Pension Unfunded Liability Reduction		
One-time funds	-75.0	-125.0
Benefit modifications	-58.0	-35.0
Total	**-133.0**	**-160.0**
Total Estimated Unfunded Retirement Liability Reductions	**-1,024.3**	**-996.8**

Note: Table does not reflect anticipated positive impacts of additional ADEC payments toward unfunded pension liabilities that begin in FY 2024. Pension unfunded liability reduction estimates for VSTRS exclude potential impacts of incrementally increasing the COLA formula when the system exceeds 80% funded. Estimates are preliminary and subject to change from further actuarial analysis and plan experience.

Additional Resources:

Pension Benefits, Design, and Funding Task Force

- Final Report: https://ljfo.vermont.gov/assets/Subjects/Pension-Task-Force-Report/82821b1335/Pension-Task-Force-Final-Report.pdf
- Website: https://legislature.vermont.gov/committee/detail/2022/367
- Actuarial Analysis: https://ljfo.vermont.gov/subjects/pensions-and-state-debt/pension-task-force-report

Pension and OPEB Actuarial and Financial Reports

- VSERS: https://www.vermonttreasurer.gov/content/retirement/state/financial
- VSTRS: https://www.vermonttreasurer.gov/content/retirement/teacher/financial-reports