Joint Public Pension Oversight Committee

Update on Vermont Pension Systems




Office of the State Treasurer
November 7, 2023

Executive Summary

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2. Experience Studies
3. Annual Valuations
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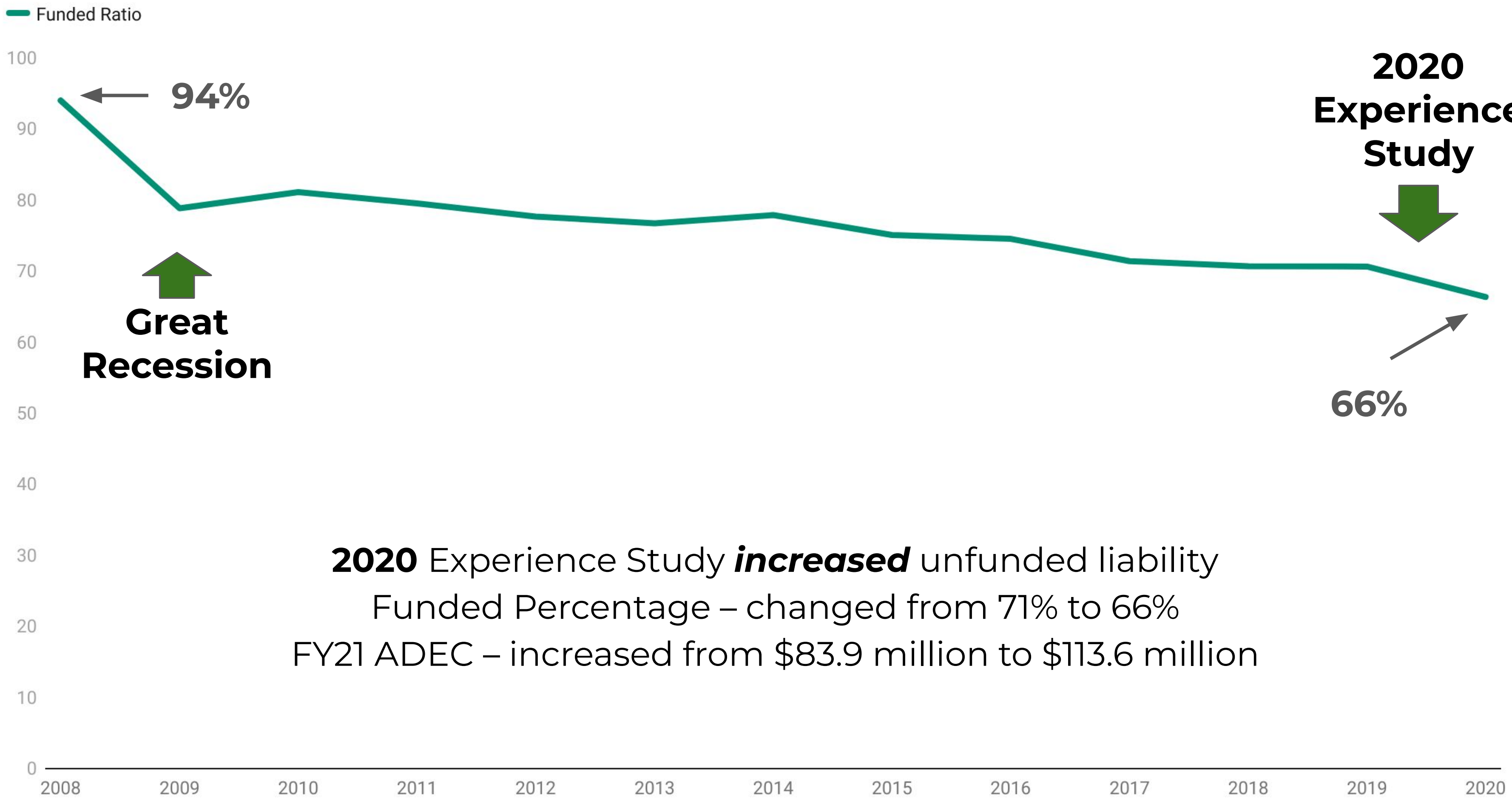
VSERS Funded Ratio 2008 to 2020

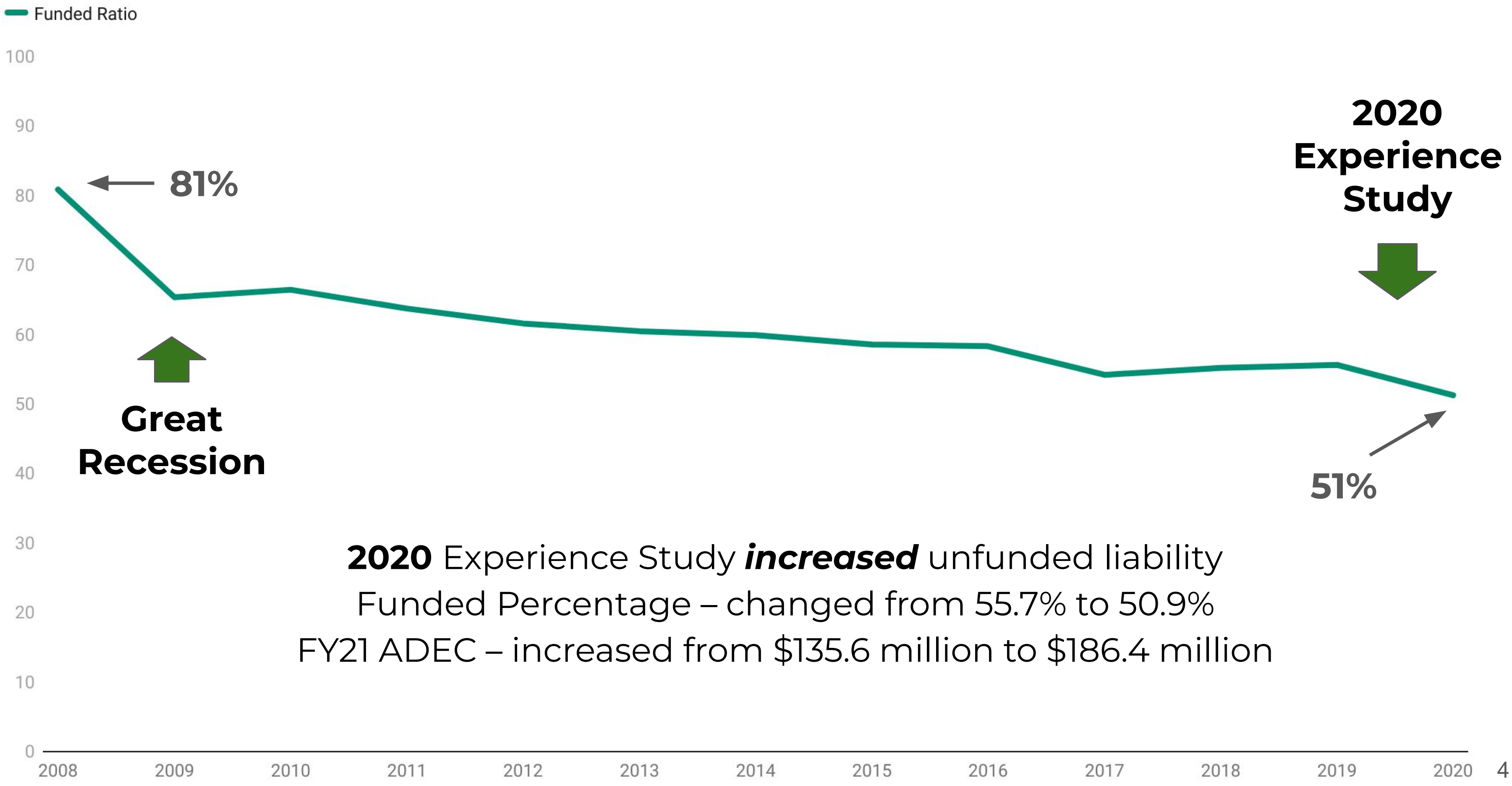


2020 Experience Study ***increased*** unfunded liability

Funded Percentage – changed from 71% to 66%

FY21 ADEC – increased from $83.9 million to $113.6 million

VSTRS Funded Ratio 2008 to 2020



2020 Experience Study ***increased*** unfunded liability
Funded Percentage – changed from 55.7% to 50.9%
FY21 ADEC – increased from $135.6 million to $186.4 million

2020 - 2021 Pension Reforms

2020

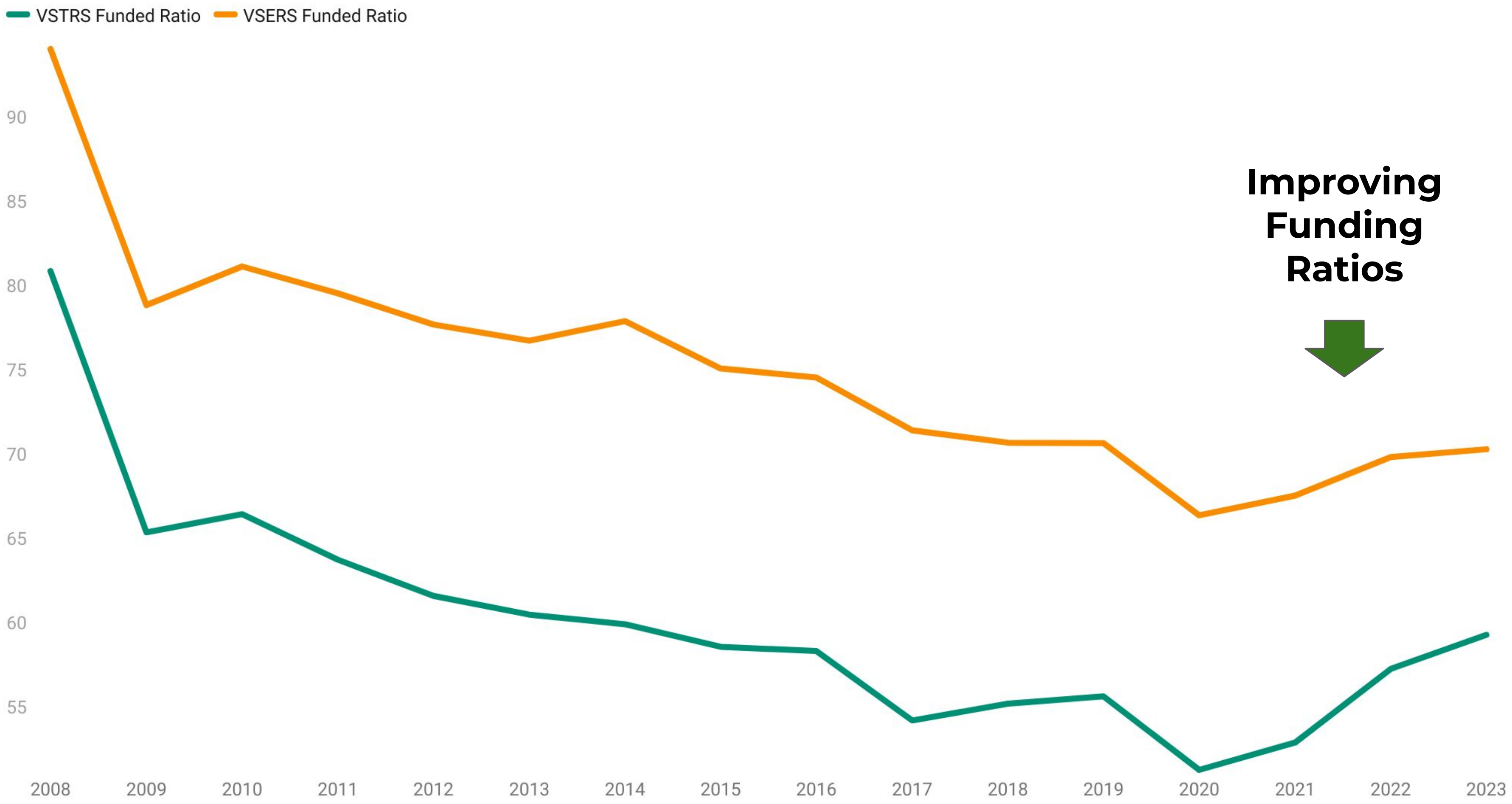
- Pension Governance Reforms
- Legislature established the Pension Benefits, Design, & Funding Task Force

2021

Legislature unanimously passed Act 114

- Provided significant one-time and ongoing additional funding
- Increased member contributions
- Made other changes to COLAs and other system provisions
- Requires pre-funding Retiree Health (OPEB) Benefits

Funding Ratios 2008 to 2023



Retirement Systems – Experience Studies

Purpose

Periodic studies that review economic and demographic assumptions against what actually happened in recent years ("experience") to assess and update assumptions

How are Assumptions Set

Actuaries look at experience to identify trends and make judgments about the future.
They use this data to set assumptions for use in Annual Valuations.
Retirement Boards review and adopt these assumptions.

Keep in Mind

No "right" answer.
Assumptions are long-term in nature.
Assumptions do not affect payment of current benefits.
Rather, they affect the size and timing of contributions, ensuring long-term solvency.

2023 Experience Studies

First Experience Studies since Act 75 (2021). Conducted by Treasurer's pension actuaries.

Experience Studies have previously been conducted every 5 years.

Now they are every 3 years.

VPIC now sets 3 key economic assumptions (rate of return, inflation, actuarial smoothing method). Retirement Boards set the rest.

These Experience Studies are based on 3-year period ending 6/30/2022. (Most recent valuation is not reflected).

Retirement Boards reviewed and approved Experience Studies at September meetings.

Experience Studies Actuarial Assumptions

Economic Assumptions

- ➢ Inflation
- ➢ Investment Return
- ➢ Salary Increase
- ➢ Payroll Growth
- ➢ COLA Amount
- ➢ Administrative Expenses

Demographic Assumptions

- ➢ Retirement
- ➢ Death After Retirement
- ➢ Death In Active Service
- ➢ Termination Before Retirement
- ➢ Disability Incidence
- ➢ Other Miscellaneous

Assumption Changes That Apply to all Three Systems

VPIC retained its own actuary (GRS) & adopted 3 key economic assumptions

- Rate of Return – 7.00%
- Inflation – 2.30%
- Actuarial Smoothing Method – 5-year

The inflation assumption is incorporated into many of the other assumptions: rate of return, salary and payroll, etc.

Slight increase in Administrative Expense Assumption to reflect new positions

Assumption Changes That Vary By System

State

*Liability **Increases** due to:*

- Salary Scale
- Mortality

*Liability **Decreases** due to:*

- COLA
- Retirement

Teachers

*Liability **Increases** due to:*

- Mortality
- Termination

*Liability **Decreases** due to:*

- Salary Scale
- COLA
- Retirement

Municipal

*Liability **Increases** due to:*

- Salary Scale
- Mortality

*Liability **Decreases** due to:*

- Retirement
- Termination

A Note About Mortality

Analysis of Mortality sought to remove the impact of the COVID-19 Pandemic by:

- Adding two additional years to the study period (pre-COVID years)
- Using CDC data to remove "excess mortality" relative to expected

2023 Experience Studies Results

2023 Experience Studies had the following impact on FY22 Valuation (changes are illustrative only)

State – Experience Study ***increased*** unfunded liability
Funded Percentage – declined from 69.9% to 69.6%
FY24 ADEC – increased from $121.9 million to $125.0 million

Teachers – Experience Study ***decreased*** unfunded liability
Funded Percentage – increased from 57.3% to 57.6%
FY24 ADEC – decreased from $194.3 million to $193.8 million

Municipal – Experience Study ***increased*** unfunded liability
Funded Percentage – decreased from 77.0% to 76.8%
FY24 ADEC – increased from $43.7 million to $44.0 million

2023 Experience Studies – Key Takeaways

- 3-year experience study cadence established in Act 75 is working.
- Allows for more incremental changes in assumptions.
- Likely to be less budget volatility during Experience Study years

- Stability in economic assumptions is the primary reason for stability in System Liabilities

- The COVID-19 years saw extra churn in the labor force
  - ➢ More people retiring earlier than expected in all Systems
  - ➢ More turnover in the State and Municipal Systems active labor force

2023 Annual Valuations

Purpose

Valuations are a tool to help project future Retirement System obligations.

It is an estimated forecast – actual long-term System costs will be determined by the actual benefits and expenses paid and the actual investment returns.

Looking Back

Valuation looks back at FY23 to see how the Plan performed against assumptions.

Note – Experience is evaluated using 2020 Experience Study assumptions, while liabilities are reconciled and calculated using the new 2023 Experience Studies' assumptions.

Valuation establishes metrics like the **FY23 funded percentage**

Assets tracked on a market value basis, and on an actuarial value basis. Actuarial value uses a 5-year smoothing methodology.

Looking Forward

The FY23 Valuations determine the **FY25 ADECs.**

Last session, the Legislature fully funded the FY24 ADECs for the State and Teachers System, plus the additional payments required by Act 114.

State Employees' System Year-over-Year

Fiscal Year 2022	
Members	**VSERS**
Active	8,324
Inactive	2,012
Deferred	815
Retired & Beneficiaries	7,963
Total	19,114
Benefits	
Total Monthly	$14,611,387
Average Monthly	$1,835
Average Annual	$22,019
Financial Position (in 000's)	
Actuarial Value of Assets	2,405,796
Actuarial Accrued Liability	3,444,134
Unfunded Liability	(1,038,338)
Funded %	69.85%

Fiscal Year 2023	
Members	**VSERS**
Active	8,611
Inactive	2,287
Deferred	844
Retired & Beneficiaries	8,058
Total	19,800
Benefits	
Total Monthly	$15,534,832
Average Monthly	$1,928
Average Annual	$23,135
Financial Position (in 000's)	
Actuarial Value of Assets	2,523,349
Actuarial Accrued Liability	3,589,070
Unfunded Liability	(1,065,721)
Funded %	70.31%

Teachers' System Year-over-Year

Fiscal Year 2022	
Members	**VSTRS**
Active	10,387
Inactive	2,932
Deferred	938
Retired & Beneficiaries	10,295
Total	24,552
Benefits	
Total Monthly	$19,619,042
Average Monthly	$1,906
Average Annual	$22,872
Financial Position (in 000's)	
Actuarial Value of Assets	2,457,374
Actuarial Accrued Liability	4,289,799
Unfunded Liability	(1,832,425)
Funded %	57.28%

Fiscal Year 2023	
Members	**VSTRS**
Active	10,618
Inactive	3,167
Deferred	998
Retired & Beneficiaries	10,431
Total	25,214
Benefits	
Total Monthly	$20,576,933
Average Monthly	$1,973
Average Annual	$23,676
Financial Position (in 000's)	
Actuarial Value of Assets	2,615,250
Actuarial Accrued Liability	4,410,042
Unfunded Liability	(1,794,792)
Funded %	59.30%

Municipal Employees' System Year-over-Year

Fiscal Year 2022	
Members	**VMERS**
Active	8,059
Inactive	3,997
Deferred	1,048
Retired & Beneficiaries	4,149
Total	17,253
Benefits	
Total Monthly	$3,887,934
Average Monthly	$937
Average Annual	$11,244
Financial Position (in 000's)	
Actuarial Value of Assets	893,224
Actuarial Accrued Liability	1,159,280
Unfunded Liability	(266,056)
Funded %	77.05%

Fiscal Year 2023	
Members	**VMERS**
Active	8,393
Inactive	4,544
Deferred	1,095
Retired & Beneficiaries	4,431
Total	18,463
Benefits	
Total Monthly	$4,388,927
Average Monthly	$991
Average Annual	$11,892
Financial Position (in 000's)	
Actuarial Value of Assets	946,401
Actuarial Accrued Liability	1,260,909
Unfunded Liability	(314,508)
Funded %	75.06%

2023 Annual Valuations – Key Takeaways 1/2

- Investment losses from last year (still being smoothed out) present headwinds.
- Despite beating 7.00% return assumption on market basis, past losses brought the actuarial return below 7.00%, resulting in actuarial losses this year.
- Actuarial value of assets is larger than market value – meaning these headwinds will persist into the future.
- Teachers System is cash flow positive (net of investments) this year without additional payments.
- Both State and Teachers Systems were net positive last year with large Act 114 additional contributions.
- When cash flow is positive, assets do not need to be sold to pay for benefits (important particularly in down years).
- In FY23, there was no additional contribution. Even before investment gains, Teachers had $10 million more in contributions than in benefits payments.
- Very encouraging trend – with additional $9 - $15 million payments going forward, we hope this trend continues.

2023 Annual Valuations – Key Takeaways 2/2

- Payroll Growth is causing some of the increase in ADECs.
- There is more hiring, particularly in State and Teachers systems, leading to higher payroll.
- While ADECs are increasing, the ADECs as a percentage of payroll are holding steady. This is partially due to changes to the contribution rate structures for employees, which decrease the employer portion of the normal cost.
- In FY23 Valuations:
  - State ADEC as percentage of payroll increased slightly
  - Teacher ADEC as a percentage of payroll decreased slightly

Background on System Funding – State and Teacher Systems

- **State Legislature** funds the Employer Contributions for the State and Teachers Systems.
- 30-year Period to pay off the Systems' unfunded liabilities.
- July 1, 2023, was an important milestone.
- Halfway point on our 30-year amortization period to fully fund the Systems. We are bending the curves.
- FY24 ADECs already appropriated, so that's one more year down.
- 14 years left – a very important time period for System funding.

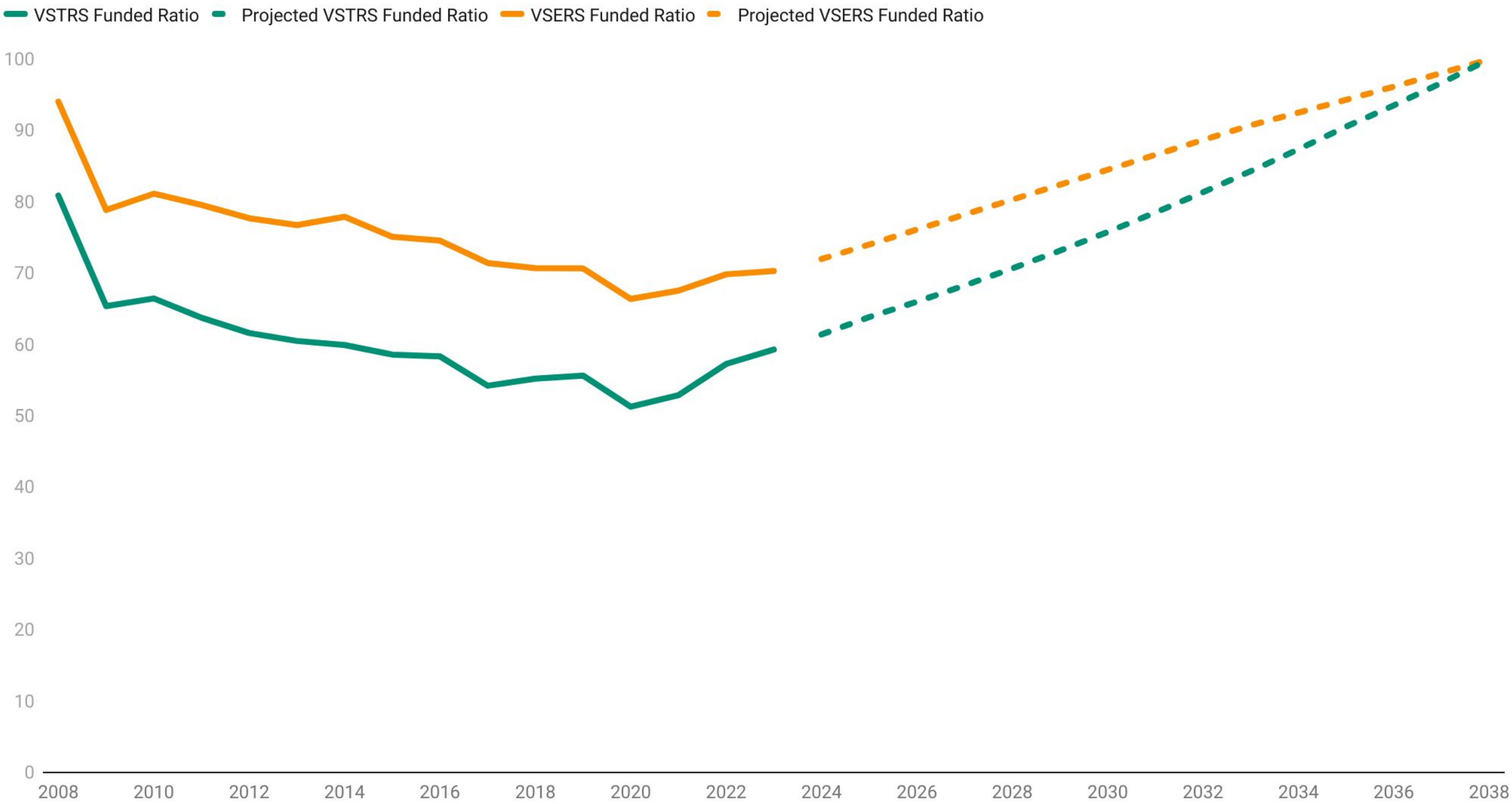
Positive Trends – State and Teacher Systems

First 15 years have required steep ramp up in ADECs. Likely to see more level ADECs and funding progress going forward due to:

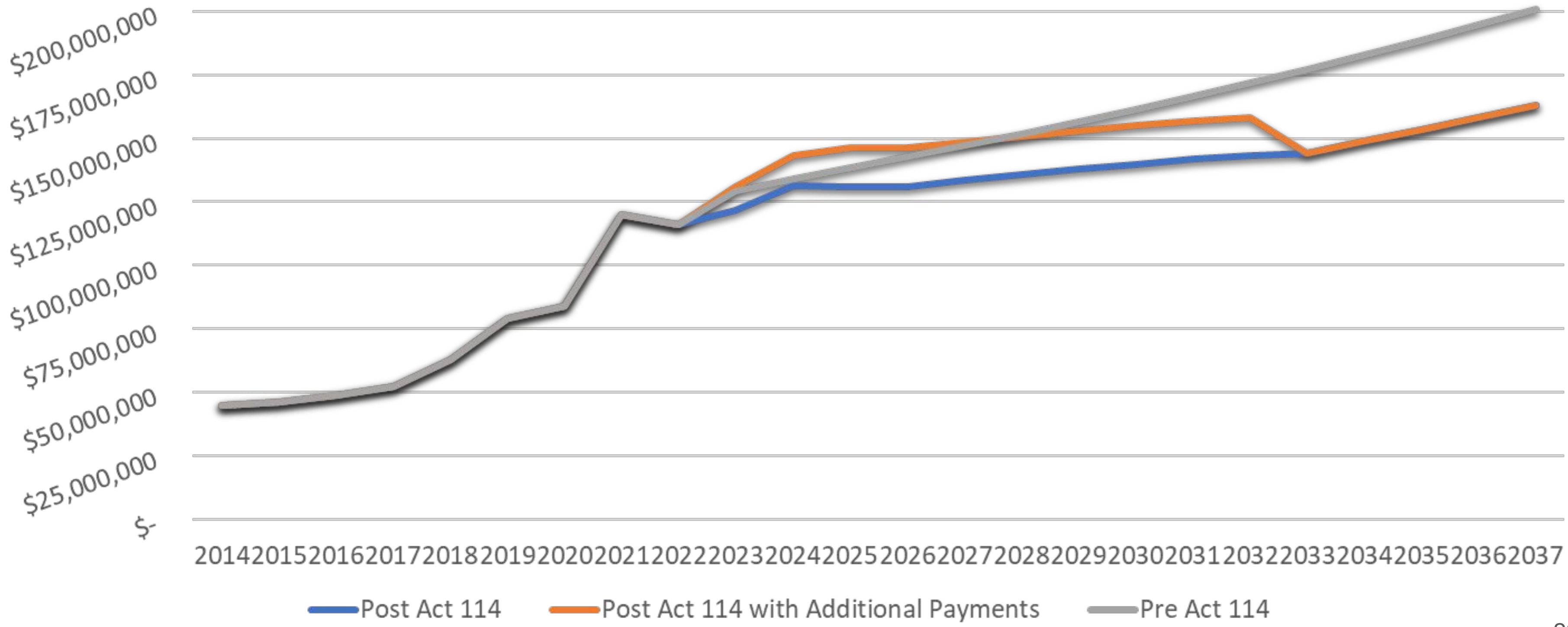
- Tightened assumptions, particularly lower assumed rate of return – something to keep a close eye on going forward
- Reduced annual increases from 5% to 3%
- No longer paying for Teacher health benefits out of the pension fund
- Act 114 and additional payments from FY24 until 90% funded (VSTRS and VSERS only)
- Increased member contributions
- COLA and other benefit changes

We are seeing the results!

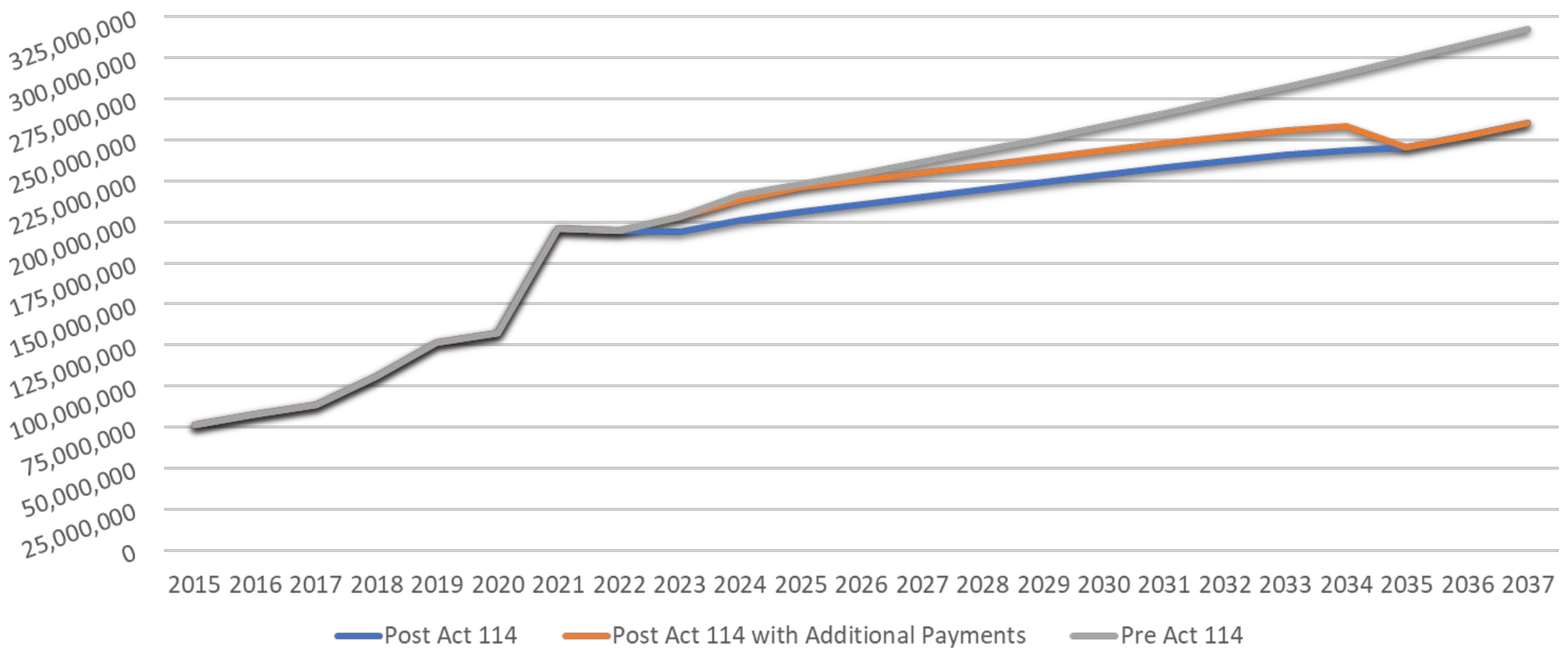
Projected Funding Ratios



Historical and Projected VSERS ADEC, Reflecting Changes From Act 114



Historical and Projected VSTRS ADEC, Reflecting Changes From Act 114



Background on System Funding – Municipal

- **Municipalities** fund the Employer Contributions for the Municipal System.
- Municipal employer rates set by the VMERS Board.
- Municipal employee rates set by the Legislature.
- History of shared increases between employers and employees – both currently see increases of 25 bps/year.
- Rates are scheduled to continue increasing through FY26 as part of a 4-year plan.
- Time to start considering the next 4-year plan to ensure robust system funding.

Background on OPEB System Funding

- OPEB stands for Other Post-Employment Benefits, primarily health insurance.
- State has historically paid for OPEB on a pay-as-you-go basis.
- Act 114 put the State on a path to fully prefunding the State and Teachers OPEB Systems by 2048.
- As reported by JFO, prefunding reduced the State's long-term liabilities by over **$1.7 billion.**
    - State – reduced liabilities by $891 million
    - Teachers – reduced liabilities by $837 million

OPEB System Funding Year-over-Year

FY24 OPEB System Funding

Last session, Legislature prefunded the Plans' ADECs. In FY24, the State is contributing:

- State - $67.1 million
- Teachers - $61.3 million

FY25 OPEB System Funding

Draft Reports have been circulated to the State and Teachers Retirement Boards. Boards meet later this week, so numbers are not final.

Plans' FY25 recommended ADECs (*not yet adopted* - based on Draft Reports):

- State - $78.3 million
- Teachers - $70.5 million

VSERS OPEB Funding Year-over-Year

Fiscal Year 2022	
Members	**VSERS**
Active	8,448
Retired	5,484
Total	13,932
Financial Position (in 000's)	
Plan Net Position	104,800
Total OPEB Liability	907,317
Unfunded Liability	(802,517)
Funded %	11.55%

Fiscal Year 2023	
Members	**VSERS**
Active	8,590
Retired	5,475
Total	14,065
Financial Position (in 000's)	
Plan Net Position	137,759
Total OPEB Liability	1,029,531
Unfunded Liability	(891,772)
Funded %	13.38%

VSTRS OPEB Funding Year-over-Year

Fiscal Year 2022	
Members	**RTHMB**
Active	9,955
Retired & Beneficiaries receiving benefits	7,280
Retired & Beneficiaries not receiving benefits	2,656
Vested termined members entitled to but not yet receiving benefits	2,001
Total	21,892
Financial Position (in 000's)	
Plan Net Position	40,508
Total OPEB Liability	758,359
Unfunded Liability	(717,851)
Funded %	5.34%

Fiscal Year 2023	
Members	**RTHMB**
Active	10,387
Retired & Beneficiaries receiving benefits	7,313
Retired & Beneficiaries not receiving benefits	2,813
Vested termined members entitled to but not yet receiving benefits	1,816
Total	22,329
Financial Position (in 000's)	
Plan Net Position	72,228
Total OPEB Liability	851,763
Unfunded Liability	(779,535)
Funded %	8.48%

OPEB System Snapshot – Key Takeaways

State OPEB System – Increase in Liabilities largely driven by:

- Increases in per capita claims.
- Increases in health care trend (cost of care)
- Increases due to normal plan operations (analogous to pension normal cost).

Teachers OPEB System – Increase in Liabilities largely driven by:

- Increases in take-up rate.
- Increases in health care trend.
- Increases due to normal plan operations (analogous to pension normal cost).

OPEB Key Takeaway: Pre-funding Works!

Even after FY23 increases in liabilities, State and Teacher OPEB liabilities are still **$1 billion lower** than before prefunding.

Assets are increasing due to State Contributions and Investment Income.

State OPEB - Market Value of Assets

	Fiscal Year Ending June 30, 2023	Fiscal Year Ending June 30, 2022
Beginning of Year	$105	$120
Employer Contributions	65	35
Benefit Payouts	(42)	(35)
Administrative Expenses	(0)	(0)
Investment Income (net)	10	(16)
End of Year	$138	$105
Rate of Return	8.7%	-13.1%

Teachers OPEB - Market Value of Assets

	Fiscal Year Ending June 30, 2023	Fiscal Year Ending June 30, 2022
Beginning of Year	$40.5	$14.6
Employer Contributions	57.2	54.2
Benefit Payouts	(34.5)	(28.1)
Administrative Expenses	(0.0)	(0.0)
Investment Income (net)	9.0	(0.2)
End of Year	$72.2	$40.5
Rate of Return	11.9%	-3.3%

Key Links - 2023 Reports

State System

- Experience Study, *available* here
- Annual Valuation, *available* here

Teachers System

- Experience Study, *available* here
- Annual Valuation, *available* here

Municipal System

- Experience Study, *available* here
- Annual Valuation, *available* here

OPEB Reports will be posted following review and approval by Retirement Boards