Act 114 Savings Report

Introduction

This report measures the fiscal impact of Act 114 of 2022—from the time of the law's passage in 2022 throughout the period of time established to retire unfunded liabilities in the State Employees and Teachers Pension Systems (FY2038) and Other Post-Employment Benefits (OPEB) Systems (FY2048).

In 2020, the funded status of Vermont's State Employees and Teachers Pension Systems was at a low point. The State Employees System (VSERS) was 65.6% funded (down from 94% in 2008) and the Teachers System (VSTRS) was 50.9% funded (down from 81% in 2008). These funding levels were caused by many factors, including historic underfunding, declining expectations of assumed investment return, and shifts in demographics (including longer life expectancies among retired members and beneficiaries), among other things.

At the same time, Vermont's OPEB Systems, which fund retiree health care, contained very limited invested assets, with benefits being provided on a pay-as-you-go basis. This meant that taxpayers were required to foot almost the entire bill for retiree healthcare each year, rather than relying on investment earnings to help fund these important benefits.

In 2021, the Legislature established the Pension Benefits, Design, and Funding Task Force. The Task Force included lawmakers, administration officials, and labor leaders and was charged to examine the Pension and OPEB Systems and make recommendations to improve the sustainability of the systems. The task force worked throughout 2021, and in early 2022, they brought forth a robust consensus package of proposed reforms. The Legislature passed the package ("Act 114") unanimously in 2022, in order to strengthen these vital systems for our public employees and deliver significant savings to Vermont taxpayers. Details of Act 114 can be found here.

Act 114 provides savings in three important ways.

1. By accelerating the pace of pension system funding from the State, the State has the opportunity to earn greater returns in its investments.
2. By requiring additional pension system contributions from active employees and adjusting their benefit levels, the State is able to contribute less and reduce its long-term liabilities and ongoing costs.
3. By prefunding the OPEB system, the State has the opportunity to earn greater returns on its investments.

In this report, we calculate savings to the State of Vermont as a result of Act 114. These savings take the form of reduced costs and liabilities from the passage of Act 114 through the period of time established to retire the unfunded liabilities in the systems. For the pension systems, that period is through FY2038, and for the OPEB Systems, that period is through FY2048. Stated otherwise, the savings are not expressed on a present value basis but are instead expressed as accumulated savings over the next many years, and they assume that the State continues to meet the funding commitments in Act 114.

Summary of Savings – Almost $6 Billion

In total, Act 114 is projected to save the State almost $6 billion from FY2022 through FY 2048, as shown in the following table.

Plan	Pension System Savings (FY2022-2038)		OPEB System Savings 2022-2048	Total by Fund
	Accelerated Pension Funding	Additional Member Contributions and Benefit Changes	OPEB System Reforms	
VSERS	$298.9	$572.9	$2,179.2	**$3,051.0**
VSTRS	$412.7	$407.4	$2,116.4	**$2,936.5**
Total	**$711.6**	**$980.3**	**$4,295.7**	**$5,987.6**
All Monetary Values Represent Dollars in Millions				

Pension System Reforms

Accelerated State Funding of the Pension System

The State Employees and Teachers Pension Systems are currently funded at 71.0% and 61.7%, respectively. The difference between the total plan liabilities and the total value of assets in each System is referred to as the unfunded liability. For the last decade and a half, Vermont has been steadily paying down the pension systems' unfunded liabilities, with a statutory goal of retiring them fully in FY2038.

Funds necessary to pay pension benefits come from three places – employee contributions, employer (i.e., State) contributions, and investment returns. Investment returns are critically important to the pension systems, as each dollar earned in investment return is a dollar that does not need to be contributed by employees or the State. And it is a fundamental precept of investing that a dollar invested now is worth more than a dollar in the future (this is commonly referred to as the time value of money).

In recognition of these principles, Act 114 sought to maximize the systems' investment earnings by accelerating State contributions. This took two forms: substantial one-time lump sum payments to both systems in FY2022,[1] and ongoing additional payments (above the actuarially determined employer contributions, or ADECs) until each system reaches 90% funded (anticipated in the State Employees System in FY2033 and the Teacher System in FY2035).

The accelerated contributions are reflected in the charts below for the State Employees and Teachers Systems. The investment returns on those accelerated contributions (calculated by using actual returns through FY2024 and the systems' assumed rate of return through FY2038) represent real savings to the State as investment-return dollars are dollars that do not have to be paid in employer or employee contributions. All told, these accelerated State contributions result in approximately $700 million of savings through FY2038.

[1] $75 million to VSERS and $125 million to VSTRS.

VSERS Pension System Employer Contributions

Year	Actual/ Expected Return	Employer Contributions		Total Savings to the State
		Accelerated State Contributions	Returns Generated on Accelerated State Contributions	
2022	-0.72%+	$75.0	($0.5)	**($0.5)**
2023	7.58%		$5.6	**$5.1**
2024	10.06%	$9.0	$9.0	**$14.1**
2025	7.00%*	$12.0	$7.7	**$21.8**
2026	7.00%*	$15.0	$9.3	**$31.1**
2027	7.00%*	$15.0	$11.0	**$42.1**
2028	7.00%*	$15.0	$12.8	**$54.9**
2029	7.00%*	$15.0	$14.8	**$69.7**
2030	7.00%*	$15.0	$16.8	**$86.5**
2031	7.00%*	$15.0	$19.1	**$105.6**
2032	7.00%*	$15.0	$21.5	**$127.1**
2033	7.00%*	$15.0	$24.0	**$151.1**
2034	7.00%*		$25.7	**$176.8**
2035	7.00%*		$27.5	**$204.3**
2036	7.00%*		$29.4	**$233.7**
2037	7.00%*		$31.5	**$265.2**
2038	7.00%*		$33.7	**$298.9**
Total Savings			**$298.9**	**$298.9**

VSTRS Pension System Employer Contributions

Year	Actual/ Expected Return	Employer Contributions		Total Savings to the State
		Accelerated State Contributions	Returns Generated on Accelerated State Contributions	
2022	-0.74%+	$125.0	($0.9)	**($0.9)**
2023	7.76%		$9.6	**$8.7**
2024	10.34%	$9.0	$14.8	**$23.5**
2025	7.00%*	$12.0	$11.9	**$35.4**
2026	7.00%*	$15.0	$13.7	**$49.1**
2027	7.00%*	$15.0	$15.8	**$64.9**
2028	7.00%*	$15.0	$17.9	**$82.8**
2029	7.00%*	$15.0	$20.2	**$103.0**
2030	7.00%*	$15.0	$22.7	**$125.7**
2031	7.00%*	$15.0	$25.3	**$151.0**
2032	7.00%*	$15.0	$28.1	**$179.1**
2033	7.00%*	$15.0	$31.2	**$210.3**
2034	7.00%*	$15.0	$34.4	**$244.7**
2035	7.00%*	$15.0	$37.8	**$282.5**
2036	7.00%*		$40.5	**$323.0**
2037	7.00%*		$43.3	**$366.3**
2038	7.00%*		$46.4	**$412.7**
Total Savings			**$412.7**	**$412.7**

All Monetary Values Represent Dollars in Millions; Numbers may not add due to rounding.
Columns shaded in green reflect savings to the State
* Expected return is based on the 7% assumed return rate
\+ Market return represents 1/12th of Annual Market return as funds were invested approx. one month prior to end of FY

Additional Employee Contributions and Benefit Changes

Act 114 also established a schedule of employee contribution rate changes based on salary quartile and set forth a series of 0.5% annual increases for a period of three to five years. Employee contributions directly reduce the amount that the State is required to contribute. Like the accelerated State contributions discussed above, these additional employee contributions also earn an investment return over time, providing further savings.

As seen in the charts below, the additional employee contributions are expected to contribute approximately $346 million to the State and Teachers Systems through FY2038; the investment returns on those additional contributions are estimated at $236 million over the same period.

Act 114 also modified the benefit structures for active employees, primarily in the terms by which future retirees will receive annual cost-of-living adjustments (COLAs). The law also modified the benefit calculations for judges.

These benefit-structure changes immediately reduced the systems' actuarially accrued liability (AAL), which represents the total cost of providing benefits now and in the future allocated to members' service earned to date. This in turn reduced the *unfunded* liability that the State is required to retire by FY2038. These benefit changes also provide an ongoing savings to the normal cost, which is the amount determined by the actuaries each year to reflect the cost of benefits accruing to active employees in any given year. Finally, these lower cost amounts mean that there is more money in the respective systems to generate an investment return. All in through FY2038, the benefit changes are expected to save almost $400 million.

The savings associated with the additional employee contributions and benefit changes are reflected in the charts below for the State Employees and Teachers Systems.

VSERS Pension System Employee Contributions & Benefit Changes

Year	Actual/ Expected Return	Employee Contributions		Benefits Change		Total Savings to the State
		Additional Member Contributions	Returns Generated on Additional Member Contributions	Reduction In Normal Cost and Actuarially Accrued Liability	Returns Generated on Reduced Cost & Liability+	
2022	-8.66%			$49.0	$0.1	$49.1
2023	7.58%	$2.8	$0.1	$2.8	$3.5	$58.3
2024	10.06%	$6.5	$0.6	$3.0	$4.0	$72.4
2025	7.00%*	$10.5	$1.0	$3.1	$4.5	$91.5
2026	7.00%*	$10.8	$1.9	$3.3	$4.9	$112.4
2027	7.00%*	$11.2	$2.8	$3.4	$5.6	$135.4
2028	7.00%*	$11.6	$3.8	$3.5	$6.2	$160.5
2029	7.00%*	$12.0	$4.9	$3.6	$6.9	$187.9
2030	7.00%*	$12.4	$6.1	$3.7	$7.7	$217.8
2031	7.00%*	$12.9	$7.4	$3.9	$8.4	$250.4
2032	7.00%*	$13.3	$8.8	$4.0	$9.4	$285.9
2033	7.00%*	$13.8	$10.4	$4.1	$10.2	$324.4
2034	7.00%*	$14.3	$12.1	$4.3	$11.3	$366.4
2035	7.00%*	$14.8	$13.9	$4.4	$12.4	$411.9
2036	7.00%*	$15.3	$16.0	$4.6	$13.5	$461.3
2037	7.00%*	$15.8	$18.2	$4.7	$14.9	$514.9
2038	7.00%*	$16.4	$20.5	$4.9	$16.2	$572.9
Total Savings		**$194.4**	**$128.5**	**$110.3**	**$139.7**	**$572.9**

VSTRS Pension System Employee Contributions & Benefit Changes

Year	Actual/ Expected Return	Employee Contributions		Benefits Change		Total Savings to the State
		Additional Member Contributions	Returns Generated on Additional Member Contributions	Reduction In Normal Cost and Actuarially Accrued Liability	Returns Generated on Reduced Cost & Liability+	
2022	-8.85%			$32.2	$0.1	$32.3
2023	7.76%	$5.7	$0.2	$1.5	$2.3	$42.0
2024	10.34%	$6.9	$1.0	$1.5	$2.6	$54.0
2025	7.00%*	$8.1	$1.2	$1.6	$2.9	$67.8
2026	7.00%*	$8.4	$1.9	$1.7	$3.1	$82.9
2027	7.00%*	$8.6	$2.6	$1.7	$3.6	$99.4
2028	7.00%*	$8.9	$3.4	$1.8	$3.9	$117.4
2029	7.00%*	$9.1	$4.3	$1.8	$4.3	$136.9
2030	7.00%*	$9.4	$5.2	$1.9	$4.7	$158.1
2031	7.00%*	$9.7	$6.3	$1.9	$5.2	$181.2
2032	7.00%*	$10.0	$7.4	$2.0	$5.7	$206.3
2033	7.00%*	$10.3	$8.6	$2.1	$6.2	$233.5
2034	7.00%*	$10.6	$9.9	$2.1	$6.8	$262.9
2035	7.00%*	$10.9	$11.5	$2.2	$7.5	$295.0
2036	7.00%*	$11.2	$13.0	$2.2	$8.1	$329.5
2037	7.00%*	$11.6	$14.6	$2.3	$8.9	$366.9
2038	7.00%*	$11.9	$16.6	$2.4	$9.6	$407.4
Total Savings		**$151.3**	**$107.7**	**$62.9**	**$85.5**	**$407.4**

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Columns shaded in green reflect savings to the State
* Expected return is based on the 7% assumed return rate
+ For Benefits Changes, the return used for each year is the assumed 7% return rate, not the actual return rate

OPEB System Reforms

The single largest source of savings from the Act 114 reforms comes from prefunding retiree health care benefits, commonly referred to as OPEB. As noted above, these important benefits had previously been funded on a pay-as-you-go basis. Act 114 committed the State to fully fund the OPEB systems by FY2048. It does so by mimicking the funding practice of the pension systems. Accordingly, each year through FY2048, system actuaries will calculate an actuarially determined employer contribution, or ADEC, that is calculated to be sufficient to both (1) pay for the normal cost of providing an additional year's worth of future benefits, and (2) pay down the unfunded liability by FY2048.

To determine the savings associated with prefunding the OPEB systems, we calculated both the projected ADECs through FY2048 and the projected benefit costs through FY2048 to determine the additional funds that Act 114 is putting in the OPEB systems. We then calculated the actual (through FY2024) and projected (through FY2048) investment returns on these additional funds to arrive at the projected savings of approximately $4.3 billion.

The savings associated with prefunding OPEB benefits are reflected in the charts below for the State Employees and Teachers OPEB Systems.

Act 114 OPEB Savings State System (VSERS)

Year	Actual/ Expected Return	Total Projected State Contribution	Projected Benefit Cost	Prefunded Amount (Contribution less Cost)	Total Savings From Prefunding
2022					
2023	8.70%	$64.6	$41.5	$23.0	$9.8
2024	12.50%	$67.1	$46.4	$20.7	$18.2
2025	7.00%*	$78.3	$67.2	$11.1	$12.7
2026	7.00%*	$94.1	$71.5	$22.7	$18.2
2027	7.00%*	$98.4	$75.6	$22.8	$21.2
2028	7.00%*	$103.0	$80.1	$22.9	$24.4
2029	7.00%*	$107.7	$84.8	$22.9	$27.9
2030	7.00%*	$112.7	$88.3	$24.5	$31.7
2031	7.00%*	$118.0	$91.7	$26.3	$35.9
2032	7.00%*	$123.5	$96.0	$27.5	$40.5
2033	7.00%*	$129.4	$99.6	$29.8	$45.5
2034	7.00%*	$135.5	$102.6	$32.9	$51.1
2035	7.00%*	$142.0	$104.3	$37.7	$57.4
2036	7.00%*	$148.8	$105.3	$43.5	$64.5
2037	7.00%*	$156.0	$107.6	$48.4	$72.5
2038	7.00%*	$163.6	$109.9	$53.8	$81.4
2039	7.00%*	$171.6	$113.5	$58.1	$91.3
2040	7.00%*	$180.1	$117.2	$62.9	$102.2
2041	7.00%*	$189.0	$120.6	$68.4	$114.3
2042	7.00%*	$198.4	$124.4	$74.0	$127.6
2043	7.00%*	$208.3	$127.7	$80.6	$142.3
2044	7.00%*	$218.8	$132.3	$86.5	$158.5
2045	7.00%*	$229.9	$136.2	$93.7	$176.2
2046	7.00%*	$241.6	$140.5	$101.1	$195.8
2047	7.00%*	$254.0	$144.4	$109.6	$217.3
2048	7.00%*	$267.1	$147.4	$119.7	$241.0
Total Savings					**$2,179.2**

Act 114 OPEB Savings Teacher System (VSTRS)

Year	Actual/ Expected Return	Total Projected State Contribution	Projected Benefit Cost	Prefunded Amount (Contribution less Cost)	Total Savings From Prefunding
2022					
2023	8.70%	$54.8	$34.5	$20.4	$9.0
2024	12.50%	$61.3	$34.5	$26.8	$13.8
2025	7.00%*	$70.5	$39.5	$30.9	$9.0
2026	7.00%*	$80.0	$42.5	$37.5	$14.9
2027	7.00%*	$83.3	$45.6	$37.7	$18.6
2028	7.00%*	$86.9	$49.1	$37.8	$22.7
2029	7.00%*	$90.6	$52.8	$37.8	$27.1
2030	7.00%*	$94.6	$57.0	$37.6	$31.8
2031	7.00%*	$98.7	$61.5	$37.2	$36.8
2032	7.00%*	$103.0	$66.3	$36.7	$42.1
2033	7.00%*	$107.6	$70.9	$36.7	$47.8
2034	7.00%*	$112.4	$75.7	$36.8	$53.8
2035	7.00%*	$117.5	$80.1	$37.4	$60.4
2036	7.00%*	$122.9	$83.8	$39.1	$67.5
2037	7.00%*	$128.5	$87.4	$41.1	$75.2
2038	7.00%*	$134.4	$91.8	$42.6	$83.6
2039	7.00%*	$140.7	$96.1	$44.6	$92.7
2040	7.00%*	$147.3	$99.8	$47.5	$102.7
2041	7.00%*	$154.2	$104.5	$49.7	$113.5
2042	7.00%*	$161.6	$109.0	$52.6	$125.3
2043	7.00%*	$169.4	$113.1	$56.2	$138.2
2044	7.00%*	$177.6	$117.3	$60.3	$152.2
2045	7.00%*	$186.2	$120.9	$65.3	$167.6
2046	7.00%*	$195.4	$124.4	$71.0	$184.4
2047	7.00%*	$205.1	$127.8	$77.3	$202.8
2048	7.00%*	$215.3	$132.2	$83.1	$223.0
Total Savings				**$1,181.8**	**$2,116.4**

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Columns shaded in green reflect savings to the State
* Expected return is based on the 7% assumed return rate