Background Information for December 3, 2009 Public Hearing
Commission on the Design and Funding of
Retirement and Retiree Health Benefit Plans

The challenge:

The Commission was created by the Vermont Legislature to review and report on the design and funding of retirement and retiree health benefit plans for the state employees' (VSERS) and teachers'(VSTRS) retirement systems. The Legislature and Governor are concerned about the affordability and long-term sustainability of the retirement plans, pension and retiree healthcare, and expect recommendations from the Commission addressing the situation.

Similar efforts are occurring across the country because the costs of maintaining retirement programs have been increasing faster than states' ability to pay for them. In Vermont, the State's combined actuarially required contribution this year is $73.5 million and, without changes being implemented, will be $103.5 million next year. That is a $32 million one year increase in a year the State is facing at least a $90 million deficit – the increase for retirement plans is not baked into that projected deficit figure.

	VSTRS Employer ARC*	VSERS Employer ARC*
FY 2009	$37,077,050	$25,333,307
FY 2010	$41,503,002	$32,013,894
FY 2011	$63,501,220	$41,581,656

*refers to the actuarially required contribution recommended in October as part of the annual valuation

Why the dramatic increase? Certainly the serious implosion of the financial markets in 2008 and the first quarter of 2009 is the largest factor this year. But, demographics and workplace trends also play an important role over time. There are 2,800 more retired teachers and state employees this year than there were in 2003. Pension benefit payouts for state employees and teachers have been increasing by roughly $10-11 million each year in recent years and, going forward, are projected to increase by $15-16 million each and every year. It is not uncommon to have employees begin drawing their pension and retiree health benefits in their early to mid fifties. With increasing life expectancies, these people may well receive retirement benefits for more years than they spent in employment for the State or school districts.

Even if investment returns experience a sustained recovery, the current level of growth in the required contributions to fund the pensions exceeds historical growth of the past 15+ years or any current long-term revenue growth projections. The independent actuary, assuming a 15% positive investment return this year, projects, based on current benefits and assumptions, the employer ARC for VSTRS will continue to escalate from $63.5 million in FY 2011 to $70.3 million in FY 2012 and for VSERS it would escalate from $41.5 million in FY 2011 to $45.5 million in FY 2012.

Payments for the 80% employer share for retiree health insurance premiums also are escalating by several million dollars a year.

	VSTRS Retiree Health Payment	VSERS Retiree Health Payment
FY 2008	$15.08 million	$16.37 million
FY 2009	$16.42 million	$17.89 million
FY 2010	$18 million estimated	$22 million estimated

The Commission recognizes that the benefit and contribution levels for both systems are modest when compared to public systems in other states. It also recognizes that the relative competitiveness of public benefits should not only be compared against other state systems, but also to what is competitive within Vermont and for the many thousands of workers in the private and other non-profit sectors. Most private and non-profit sector employers and members of the public do not have comparable benefits. Total compensation (salary and benefits) must be considered when making comparisons between the public and private sectors.

The ideas and scenarios in this document are not final recommendations. There may be other options that will result in a realistic scenario for ensuring the sustainability of these benefit plans, while meeting the objective of providing quality retirement plans for our public employees. Suggestions from any and all parties are welcomed and appreciated.

What we are not considering:

Changes to pension or retiree health benefits for those already retired.

Changes to pension or retiree health benefits for anyone close to retirement - within five or ten years of retirement eligibility.

Ending the current defined benefit plan and moving to a defined contribution plan.

Making the basic provisions (maximum benefit, multiplier, COLA, etc.) of our plan significantly less competitive or generous than those of other state public systems.

What we are considering on the pension side:

Revisions to normal and early retirement ages:

State Group F and Teachers' Group C:

► Raise normal retirement age from 62 or 30 years at any age to 65 or rule of 90 (combination of age and years of service) for those more than five or ten years from normal retirement eligibility.

► Raise the early retirement age from 55 to 58 for those more than five or ten years from early retirement eligibility.

State Group D:

► Raise normal retirement age from age 62 to age 65 for those more than five or ten years from normal retirement eligibility.

State group C:

► Raise the early retirement age to 52 from 50 for those more than five or ten years from early retirement eligibility.

Lengthening the salary compensation period:

State Group F and Teachers' Group C:

► Use a five year compensation period instead of a three year period to calculate benefits for those more than five or ten years from retirement eligibility.

State Group C:

► Use a three year compensation period instead of a two year period to calculate benefits for those more than five or ten years from retirement eligibility.

State Group D:

► Use a two year compensation period instead of final salary to calculate benefits for those more than five or ten years from retirement eligibility.

Possibly increasing the maximum benefit from 50% to 60% of final compensation for State Group F and Teachers' Group C. This would provide an opportunity for increased benefits to employees who work longer.

Reviewing contribution rate ratios for employer and employees:

Implementing a proportional linkage (50/50, 60/40) between the employer and employee contributions so that employer and employee contributions rise and fall in tandem, to accomplish a partnership – share the gain, share the pain. This could be accomplished by a sharing of the total annual contribution developed by the actuary or on a going-forward basis using FY 2010 as a baseline. For demonstration purposes, assuming no changes on the benefit side and on a 50/50 going-forward basis, preliminary estimates show this would increase the FY 2011 VSERS employer contribution percentage to 8.7% from 7.57% and increase the Group F and D employee contribution to 6.23% from 5.1%. For VSTRS this would increase the employer contribution percentage to 9.28% from 7.41% and increase the employee contribution to 5.27% from 3.4%.

Employer/employee contribution levels as a percentage of payroll:

	Teachers		State Employees	
	Employee	Employer	Employee	Employer
FY 2009	3.4%	6.88%	5.10%	6.27%
FY 2010	3.4%	7.41%	5.10%	7.57%
FY 2011	3.4%	10.82%	5.10%	9.84%

The cost-sharing approach would result in increased contributions for both the State and employees, but preserve the fundamental structure of benefits. While sharing would increase the contribution rates now for both parties, it provides the opportunity to both parties to benefit with reductions in rates should financial markets experience a sustained recovery and/or plan costs are reduced. For example, if the contribution rates are adjusted in combination with the scenarios described earlier in this document, using the five year window, the necessary increase in the rate would be much less, with an employee contribution rate of approximately 5.67%, instead of 6.23%, for VSERS, and 4.74%, instead of 5.27%, for VSTRS.

What we are considering on the retiree health insurance side:

One proposal under consideration by the Commission is a tiered medical premium copayment structure based on length of service. Instead of the current straight 80/20 split of retiree health insurance premiums, a new tiered system would apply to all of those not within five or ten years of eligibility to draw this benefit.

The new employer share for the tiered system would be:

30% - 10yrs 50% - 15 yrs 70% - 20 yrs
Or
40% - 10yrs 60% - 15 yrs 80% - 20 yrs

Provide ability to “recapture” health benefit with 20 years of service upon drawing benefits.

Possibly add spouses to coverage for VSTRS members (this would require an increase in employee contribution to make this work).

VSTRS only – Reconfigure funding source of employer share for pension and/or retiree health insurance:

Currently, the "employer" share of the pension contribution is made by the State. The 80% "employer" share of retiree health insurance is paid from the pension fund. There is no local contribution for either pension or retiree health insurance. However, local decisions and compensation levels do have an effect on the costs.

In order to improve transparency for total educational expenditures, increase accountability between incurrence of liabilities and responsibility to pay, and to improve the likelihood of full funding on a consistent, dependable basis, one scenario the Commission has reviewed would:

- Continue to pay for unfunded pension liabilities (about 2/3 of the total contribution) from General Fund and would transfer normal costs to Education Fund or directly to local districts with multi-year phase-in.
- Continue paying the employer share of VSTRS retiree health insurance for those already on job as is. For new hires, districts would be assessed on a prefunding actuarial basis with the proceeds deposited in a dedicated trust fund to pay for future health care.
- Revise VSTRS Board Governance by increasing membership from six to seven, adding a school board member and a superintendent and removing the BISHCA Commissioner or designee.

It is important to note that the ideas and scenarios in this document are under discussion by the Commission, but have not been voted on as recommendations. Your reaction to the ideas and scenarios within, as well your suggestions for other ideas to meet the challenge, are welcomed and important as we develop final recommendations.