On September 22, 2021, I presented testimony to the Task Force on the present OPEB pre- 
funding proposals to the Task Force. Please find updated OPEB proposals. The reasons for these 
updates are:

1) to update budgets and plans based on the 2021 OPEB Valuations received in December;

2) to address questions we have received from Task Force members and JFO; and

3) most importantly, to reiterate the Treasurer’s Office’s request for the enactment of prefunding. 
As I stated in September, the issue of prefunding has been presented to, and vetted by, legislative 
committees year after year. It is essential that the General Assembly adopt, and the Governor 
enact, OPEB prefunding in the 2022 legislative session for FY2023.

Key Update to Our Request

- The Treasurer’s Office is requesting an additional sum of $15,104,597 to prefund the 
VSTRS OPEB from the Education fund, consistent with the Senate Appropriations 
Proposal in FY2022. This is above the net Pay-Go amount of $29,606,128 detailed 
below and represents the Pre-Funded Normal Cost for FY23, and an alternative pre- 
funding method when combined with a commitment in statute.

- We are still recommending appropriation of the ADEC for the State OPEB as outlined 
below.
VSERS OPEB – Pay-Go Budget Request (Additional Prefunding Request Discussed below)

For the FY2023 Budget, the current estimated state funding of the VSERS OPEB fund on a Pay-go basis is as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Fund Appropriation Request *</td>
<td>$42,336,204</td>
</tr>
<tr>
<td>FY2022 Budget</td>
<td>$37,206,521</td>
</tr>
<tr>
<td>Increase</td>
<td>$5,129,683</td>
</tr>
</tbody>
</table>

Please note that this is not a discrete number in the budget request. Costs are allocated to employer departments/cost centers among funds. The amount allocated to the General Fund will depend on actual budgets adopted by the General Assembly, but historically the General Fund share is 36-40%. Using the 40% threshold, the General Fund estimate is $16,934,482. Also, based on a review in 2018, 23% of the funds total is reimbursed through federal funds.

The FY2023 budget is an increase of $5,129,683, compared to FY2022. Retirees receive the same health plan as active state employees, although the total level of subsidization is below the 80% threshold for state employees.1 The State has, and will likely continue to see, increased retirements consistent with trends across the country.

VSERS OPEB – Prefunding the ADEC

The actuary has calculated an actuarially determined employer contribution (ADEC) for prefunding the VSERS OPEB liability. Based on current policy of non-funding of the ADEC, the actuary determined a funding need of $122,114,722 for FY2023, inclusive of $42,336,204 in General Fund appropriation request toward Pay-go funding. If, on the other hand, the State were to adopt a pre-funding policy, the ADEC would decrease substantially, to $64,577,985. The estimated 40% allocation to the General Fund is $25,831,194. The “lift” to get to prefunding for the VSERS OPEB is $22.2 million; the impact on the General Fund is $8.9 million. If we continue down the path of pay-go, the VSERS OPEB would need $122,114,722 in FY2023, and an increasing amount each year to avoid depletion of resources for health benefits in the future. That is a substantial increase to the taxpayer burden. The value of compound interest, combined with fiscal discipline is obvious. The Treasurer's Office continues to formally include the full amount of prefunding in its annual budget request.

VSERS has benefited from statute requiring the allocation of 50% of any surplus funds, after satisfying statutory reserves. Currently, the plan’s assets are $120,267,813, an increase of $62.7 million in the last year (much from a contribution related to the surplus of FY2022 of $52.4 million). These reserves are very helpful and do have the impact of reducing the ADEC, but the

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1 For employees hired on or after 7/1/08 and upon retirement, the amount the State pays toward retiree medical coverage is based on years of service at retirement as follows: 5-9 yrs., no subsidy; 10-14 yrs. 40% State subsidy, 15-20 yrs. 60% State subsidy, and 20+ yrs. 80% State subsidy.
fund is only funded 7.55% of the total OPEB liability. Because these surplus dollars are not predictable from year to year, and as seen in FY2020, may not occur at all, they are not considered part of a pre-funding policy.

VSERS OPEB - The Unfunded Actuarially Accrued Liability (UAAL)

The VSERS OPEB liability (after application of all existing assets) as of June 2021 is $1,473,073,282. That is an increase of $47,695,633 from the prior valuation. We will continue to see a pattern of increases if we continue to use Pay-go practices. The projected FY2023 UAAL is $1,664,236,504. If we were to prefund, the UAAL is estimated at $772,943,961. That is a decrease in liabilities of $891,292,543, even more than our projection of approximately $861.8 last year.

VSTRS OPEB – Pay-Go Budget Request (Additional Prefunding Request Discussed below)

For the FY2023 Budget, the current estimated state funding of the VSTRS OPEB fund on a Pay-go basis is as follows:

<table>
<thead>
<tr>
<th>General Fund Appropriation Request</th>
<th>$29,606,128</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2022 Budget</td>
<td>$35,093,844</td>
</tr>
<tr>
<td>Decrease</td>
<td>($5,487,716)</td>
</tr>
</tbody>
</table>

The General Fund Appropriation Request is a distinct budget item. It is net of some offsets. When the VSTRS OPEB (otherwise known as the Retired Teachers Health and Medical Benefit Fund or RTHMB) was created, effective 2015, it included “buy in” at the local level through the application of a “New Teacher Healthcare Assessment” for each new teacher hired. The sum is increased each year by estimates of hires and inflation. For FY2023 that local receipt is budgeted at $6,091,170 lowering the State’s appropriation. In the past, federal Employer Group Waiver Plan (EGWP) reimbursements have been received, also reducing the appropriation. Due to the adoption of a group “Medicare Advantage Plan” called Vermont Blue Advantage (VBA), the EGWP will no longer be received; however, the savings from VBA will more than offset the loss of EGWP.

The VBA contract will result in substantial reductions in premium costs to Medicare-eligible retirees, ranging between 30% and 40%, depending on the specific retire insurance plan, as well as significant enhancements for most participants, including a new vision and hearing benefit. The State will also see significant savings, although offset by transition costs and significant

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2 The current new Teacher Assessment is scheduled to sunset effective 7/1/23. This was necessary to meet certain government accounting standards with the implementation of GASB 74. The plan is to reinstate the assessment effective FY2024. Local “buy in” will continue. Also, included in the funding request for VSTRS is $6,887,869 based on federal grant assessments, which are based on current education workforce patterns and current federal education grants to Vermont. While these are an appropriation in the RTHMB Fund, it is a reduction to the pension fund, again providing “buy in” at the local level. Should the workforce patterns or federal education grants change, we would have to reevaluate this amount.
projected increases in teacher retirements. The net result, however, is a decrease in the General Fund appropriation for employer premiums despite upward demographic pressures.

The Treasurer’s Office is also requesting an additional sum of $15,104,597 from the Education fund, consistent with the Senate Appropriations Proposal in FY2022. This is discussed below.

VSTRS OPEB – Prefunding

On September 1, 2020, we submitted a memo with a four-point plan to the legislative leadership and the House and Senate Government Operations and Appropriations Committees. That plan included the following initiatives:

1. Work with our actuaries to incorporate a portion of VSTRS claims experience to adjust use of national health care trend rates, lowering the liability.
2. Review alternative structures for VSTRS health care in a Request for Proposals with the goal of reducing expenditures while maintaining the current level of benefits.
3. Develop statutory changes to invest OPEBs in either the Trust Investment Account or with pension funds while maintaining segregated accounting; and
4. Resubmit a prefunding policy to the General Assembly.

Since submitting the plan in September 2020, the Treasurer’s Office has facilitated significant developments with respect to each of the above initiatives. The VSTRS claims experience is superior compared to national trends. By integrating these into the trend rates, the liabilities were reduced by approximately $25 million. The VBA plan not only reduced premiums but lowered the unfunded liability by $75 million. The General Assembly enacted legislative changes that permit investments in other vehicles that will maximize return, and lower employer and employee costs. Funds were recently moved to the Trust Investment Account and the Treasurer’s Office is working with VPIC on the asset allocation and a memorandum of understanding prior to moving a portion into pension fund investment vehicles.

RTHMB OPEB Prefunding Approach #1

Moving dollars to VPIC requires assets to meet economies of scale. Unlike the VSERS OPEB with assets of $120,267,813, the VSTRS OPEB or RTHMB has asset assets of $14,633,493. The Governor’s budget has not included the necessary incremental dollars to move toward prefunding as requested by the Treasurer’s Office. However, RTHMB unfunded liabilities, including the normal cost, are lower than those of the VSERS system, providing options to phase into prefunding.

The Treasurer’s Office is submitting two proposals 1) a “graduated funding scale” which, according to our actuaries, would meet the requirements necessary for prefunding and 2) a proposal recommended by Senate Appropriations. According to our actuaries, this alternative
also meets the requirements for prefunding. The Senate Appropriations approach, paying normal cost from the Education Fund, is the option included in the Treasurer’s budget request.

Scenario #1 was submitted FY19, FY20, again in FY21 and outlined to the Task Force in September 2021. The current model is based on the 2021 proposal. Since the actuary has already done extensive work on this proposal, our Office does not want to accrue additional costs, unless the Task Force and General Assembly make a commitment to move forward. It will be necessary to roll forward this scenario into FY2023, but the method and parameters are still valid for preliminary analysis.

This approach would require a policy for a graduated funding scale to fund the liability gap over time. It builds up to the actuarially determined contribution, in incremental prefunding contribution (IPC) based on a funding schedule established in statute. The objectives would be to meet requirements to be recognized as prefunding and attain full funding no later than the current amortization period, end of FY2049. The elements are as follows:

- FY2022 employer contribution at requested amount of $41,818,509.
- FY2023, FY24, and FY25 employer contribution at 10% increases annually.
- FY26 – FY49 at 3% increases annually.
- There is a one-time increase to the $35.1 million Year 1 base appropriation of $6.7 million, bringing it to the $41.8 million noted above.
- There is a one-time additional $13.3 million added to the first year to provide some volatility risk.
- The analyses reflect teachers hired after the latest valuation date. Hires after that date would be funded using the “New Teacher Healthcare Assessment”
- The assumed interest rate is at 7%, consistent with pension funds but was also “stress tested” at 6.25%.
- Statutory language to codify the funding policy will be needed. That language was developed in February 2021 although some minor adjustments may be necessary.

The result of the analysis is that prefunding would occur, and full funding would be achieved in FY2046 at the 7% scenario and FY2048 in the 6.25% scenario, both ahead of the stated objective of FY2049.
RTHMB OPEB Prefunding Approach #2 (Developed by Senate Appropriations in FY2021)

During the most recent legislative session, the Senate Appropriations Committee developed an alternative approach to prefunding. Our consulting actuaries have stated that this also meets the requirements to employ prefunding:

- The amount determined necessary to pay all retiree health and medical benefits, including prescription drug benefits (essentially pay-go) will be paid for out of the General Fund.
- The amount determined in the most recent actuarial valuation to be the “normal cost”, $15,104,597 will be appropriated from the Education Fund.

This will provide some relief to the General Fund and the normal cost for retiree health care would be an appropriate cost for the Education Fund.

VSTRS OPEB - The Unfunded Actuarially Accrued Liability (UAAL)

The VSTRS Net OPEB liability (after application of all existing assets) as of June 2021 is $1,275,587,042. That is an increase of $16,186,733 from the prior valuation. Despite beneficial contractual changes and positive claims experience, we will continue to see a pattern of increases if we continue to use pay-go practices. The projected FY2023 UAAL is $1,504,546,662. If we were to prefund, the UAAL is estimated at $667,756,829. That is a decrease in liabilities of $836,789,833 more than our projection of approximately $821.9 million last year.

Conclusion

The Treasurer’s Office respectfully requests that the Task Force, the General Assembly, and the Governor adopt these recommendations. Failure to favorably act on these proposals will only cost all taxpayers more money in the long run and place benefits in jeopardy sometime down the road. We have an obligation to pay our liabilities and, when creating budgets, recognize both the short-term and the long-term consequences. The time to prefund and invest resources, with a substantial future payback, is now.