House Retiree Health Care Reforms Committee

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Retiree Health Benefits
The Funding Issue

- Unlike pensions, health benefits have not been pre-funded (most pension plans nationwide have not pre-funded health benefits either)
  - No investment income to help pay the costs
- Costs rise as more members retire, and health inflation outpaces general inflation
- Pre-funding contribution rates have been calculated since 1999 – but pre-funding contributions have not been made *

* *During the 1980s, pre-funding contribution rates were calculated, and some pre-funding contributions were made. Those pre-funding assets were spent (used to pay benefits) in the early 1990s.*

Governmental Accounting Standards Board

- Beginning with the 2007 CAFR, GASB Statements No. 43 and No. 45 specify how retiree health benefit liabilities and expenses are reported in financial statements
- The reported annual expense is called the Annual Required Contribution (ARC)
- If the employer fully funds the actuarially computed ARC, in a qualified trust with a long-term investment policy, then the liabilities and ARC are based on a long range investment return assumption (approx. 8%)
- If the employer only pays the cash benefits, with no pre-funding, the liabilities and ARC are based on a short term investment return assumption, like that earned on the employer's general accounts (approx. 4%) – and the liabilities and ARC are much larger

Governmental Accounting Standards Board

- The reported liability and ARC depend on how the employer is funding the benefits
- If the employer funds more than the cash benefits but less than the full actuarial contribution (partial pre-funding), the liabilities and ARC will lie somewhere between the pre-funding and cash funding results
- Existing employer contributions to pay the cash benefits count as contributions towards meeting the ARC

Public Schools – Funding Valuations

- Annual Expenditures for Retiree Health Care:
  - 2006: $694 million
  - 2007: $654 million
- 2006 Potential Unfunded Accrued Liability and ARC:

	Unfunded Liability	ARC	
		Dollars	% of Payroll
Old Assumptions	$13.2 billion	$1.44 billion	14.17%
New Assumptions	**$15.4 billion**	**$1.62 billion**	**15.97%**

Potential Unfunded Liability and ARC from September 2006 valuations.

Annual Expenditures from 2007 CAFR.

New assumptions are more conservative, reflecting higher projected health care cost increases, and age grading of premiums.

Medicare Advantage payments will likely reduce the potential unfunded liability and ARC.

State Employees – Funding Valuations

- Annual Expenditures for Retiree Health Care:
  - 2006: $363 million
  - 2007: $364 million
- 2006 Potential Unfunded Accrued Liability and ARC:

	Unfunded Liability	ARC	
		Dollars	% of Payroll
Old Assumptions	$7.5 billion	$609 million	20.65%
New Assumptions	**$8.2 billion**	**$647 million**	**21.95%**

Potential Unfunded Liability and ARC from September 2006 valuations.

Annual Expenditures from 2007 CAFR.

New assumptions are more conservative, reflecting higher projected health care cost increases, and age grading of premiums.

Medicare PDP and Medicare Advantage payments will likely reduce the potential unfunded liability and ARC.

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MPSERS – GASB Compliant Valuation Full Actuarial Funding

- 2006 Potential Unfunded Accrued Liability and ARC:

	Unfunded Liability	ARC - FY2007	
		Dollars	% of Payroll
Full Actuarial Funding	$15.4 billion	$ 1.62 billion	15.97 %
Less Actual FY2007 Employer Contribution		$(0.67 billion)	(6.55)%
Additional Employer Contribution to Fully Fund the ARC		**$ 0.95 billion**	**9.42 %**

- Lump sum of $15.4 billion would fully fund the 2006 unfunded liability
- Once fully funded, the annual employer contribution requirement decreases to the normal cost
- Employer normal cost is 6.87% of payroll ($697 million in the first year)

Potential Unfunded Liability and ARC from September 2006 GASB valuation.

Medicare Advantage payments will likely reduce the potential unfunded liability and ARC.

MPSERS – GASB Compliant Valuation Full Actuarial Funding vs. Cash Funding

- 2006 Potential Unfunded Accrued Liability and ARC:

		ARC - FY2007	
	Unfunded Liability	**Dollars**	**% of Payroll**
Full Actuarial Funding	$15.4 billion	$1.62 billion	15.97%
Cash Funding	$24.8 billion	$2.50 billion	24.60%

- Lump sum of $15.4 billion would fully fund the 2006 unfunded liability (annual normal cost thereafter)
- The $24.8 billion amount is for reporting and disclosure purposes (if cash funding is continued), and is not an amount that needs to be funded in a lump sum
- $9.4 billion ($24.8 less $15.4) represents some of the lost investment income from not pre-funding

Potential Unfunded Liability and ARC from September 2006 GASB valuation.

Medicare Advantage payments will likely reduce the potential unfunded liability and ARC.

SERS – GASB Compliant Valuation Full Actuarial Funding

- 2006 Potential Unfunded Accrued Liability and ARC:

	Unfunded Liability	ARC - FY2007	
		Dollars	% of Payroll
Full Actuarial Funding	$8.2 billion	$ 647 million	21.95 %
Less Actual FY2007 Employer Contribution		$(359 million)	(12.18)%
Additional Employer Contribution to Fully Fund the ARC		**$288 million**	**9.77 %**

- Lump sum of $8.2 billion would fully fund the 2006 unfunded liability
- Once fully funded, the annual employer contribution requirement decreases to the normal cost
- Employer normal cost is 5.21% of payroll ($154 million in the first year)

Potential Unfunded Liability and ARC from September 2006 GASB valuation.

Medicare PDP and Medicare Advantage payments will likely reduce the potential unfunded liability and ARC.

SERS – GASB Compliant Valuation
Full Actuarial Funding vs. Cash Funding

- 2006 Potential Unfunded Accrued Liability and ARC:

	Unfunded Liability	ARC - 2007	
		Dollars	% of Payroll
Full Actuarial Funding	$ 8.2 billion	$647 million	21.95%
Cash Funding	$13.5 billion	$899 million	30.49%

- Lump sum of $8.2 billion would fully fund the 2006 unfunded liability (annual normal cost thereafter).
- The $13.5 billion amount is for reporting and disclosure purposes (if cash funding is continued), and is not an amount that needs to be funded in a lump sum.
- $5.3 billion ($13.5 less $8.2) represents some of the lost investment income from not pre-funding.

Potential Unfunded Liability and ARC from September 2006 GASB valuation.

Medicare PDP and Medicare Advantage payments will likely reduce the potential unfunded liability and ARC.

Recent Reform
Public Schools – PA 110 of 2007

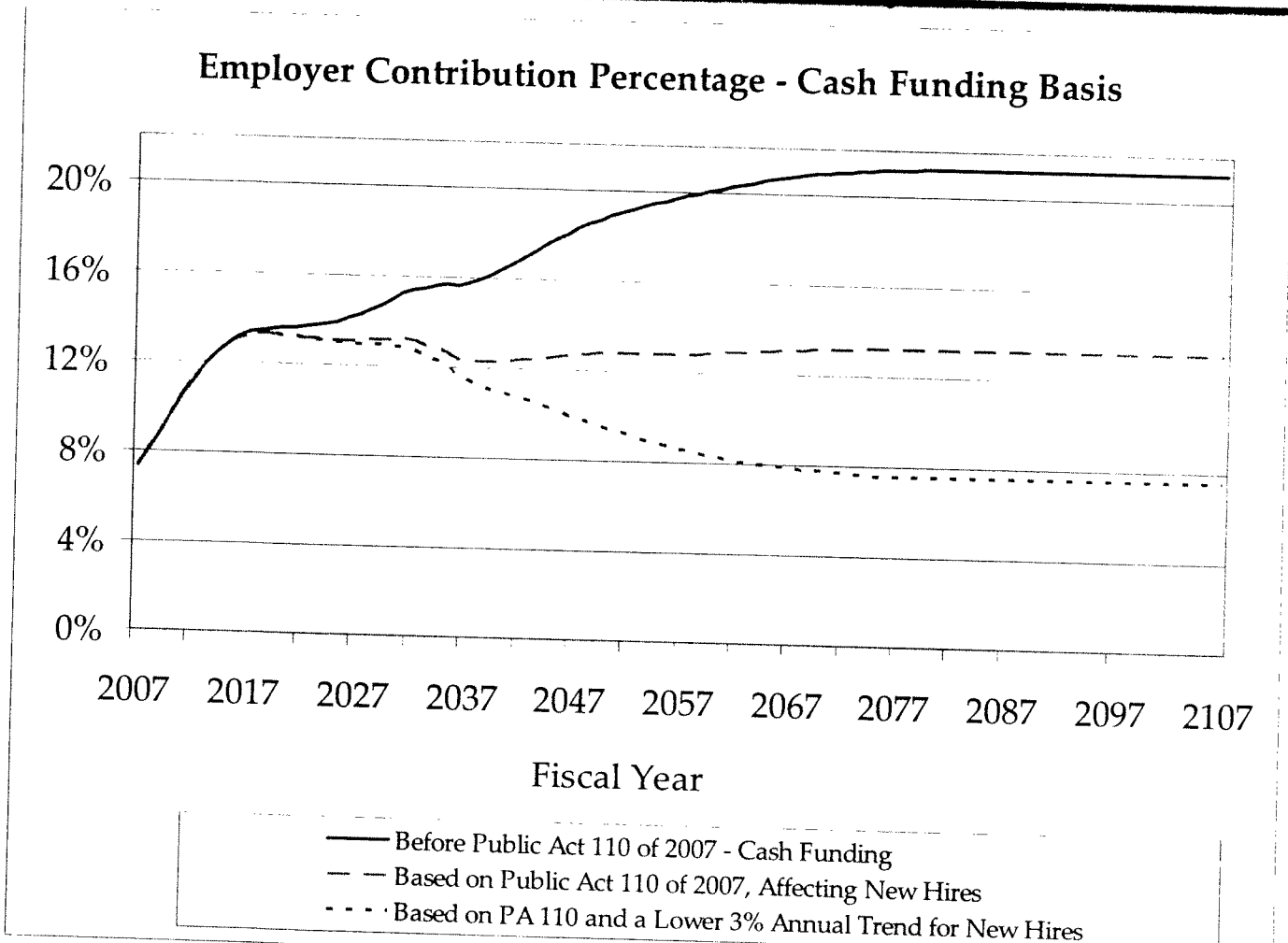
- School employees hired after June 30, 2008 will be eligible for a graded retiree health premium subsidy based on *credited* service:
  - Under 10 years: No subsidy
  - 10 years: 30% subsidy
  - Over 10 years: 4% per additional year
  - 25+ years: 90% subsidy
- If the member retires before age 60 with fewer than 25 years of *actual* service, the subsidy does not start until age 60

Public Schools
Costs after PA 110 of 2007

- The current cash funding employer contribution rate for retiree health benefits is 6.55%
- Before PA 110, the cash funding contribution rate was projected to increase over the next 50 years to around 20% of payroll
- After PA 110, the cash funding contribution rate is projected to increase much less: to about 10% - 11% of payroll by 2017, stabilizing at that level in later years
- Of course, the actual future rates will depend entirely on future per capita health cost increases (health inflation) *

* *Per capita costs are projected to increase 10% the first year, graded down to 3.5% in the twelfth and later years. For comparison, per capita costs increased 6.6% annually (compounded) from 2000 to 2006.*

Public Schools
Retiree Health Cost Projections



Medicare PDP and Medicare Advantage payments will likely reduce the long range contributions by 1%-3% of payroll.

Employer contributions are shown as a percentage of active member payroll.

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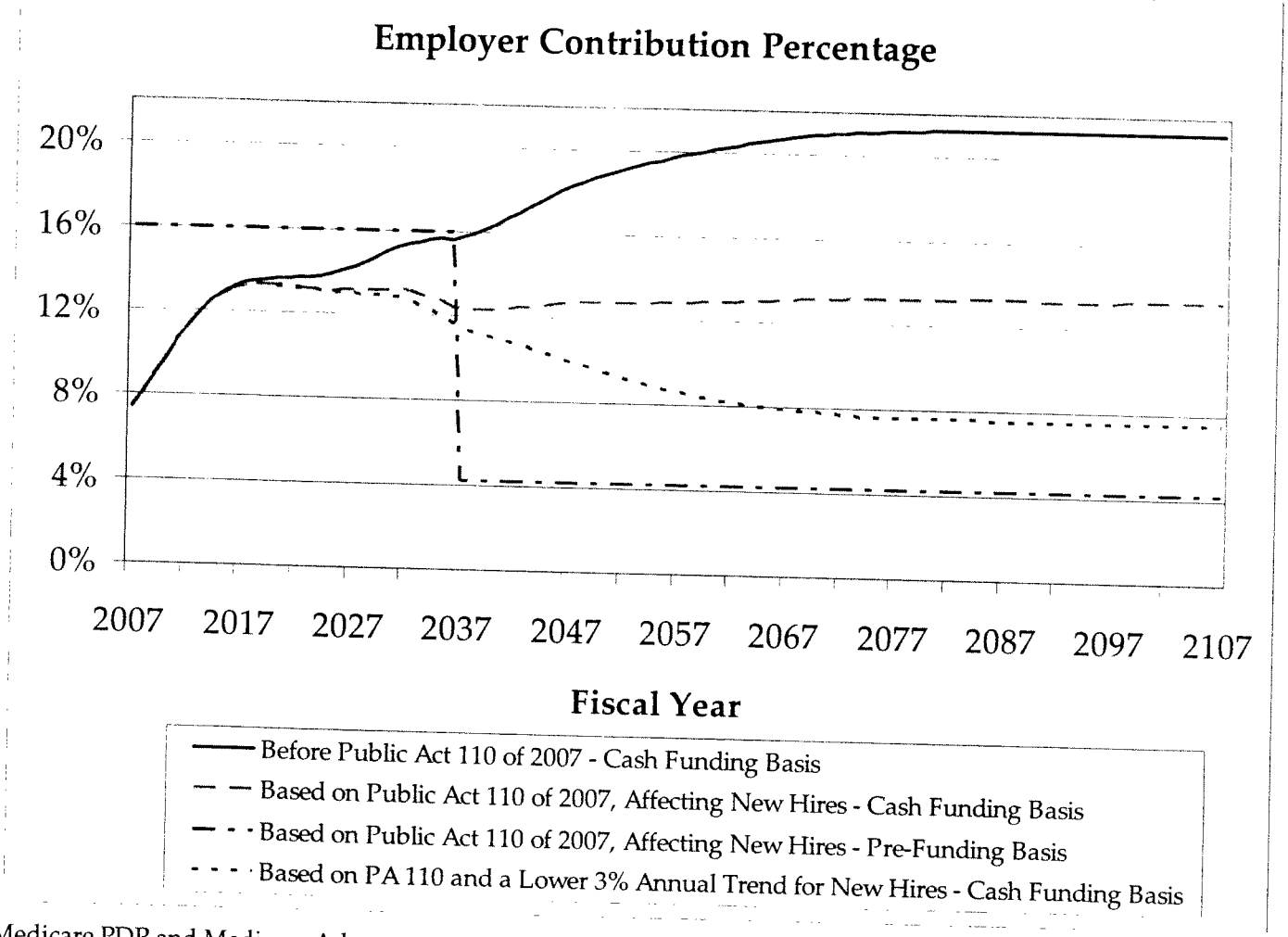
Public Schools
Retiree Health Cost Projections



Medicare PDP and Medicare Advantage payments will likely reduce the long range contributions by 1%-3% of payroll.

Employer contributions are shown as a percentage of active member payroll.

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Circumstances That Would Increase Projected Costs

- Medicare funding reductions or cost shifting
- Unexpected new entrants into the retiree health plan (from health benefit cutbacks of other employers)
- Medical inflation worse than assumed
- Active member population decline (contribution rates as a percentage of payroll would increase)
- This is not a complete list

Solutions and Observations

- Continue strategic planning – an important tool to contain costs while delivering valuable benefits
- Plan for increases in employer health care contribution rates during the next 10 years
- PA 110 mitigates a significant portion of the long term projected contribution rate increase
- Partial pre-funding (more than cash funding, but less than GASB ARC) may protect against higher costs if experience is worse than projected

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