



# Michigan State Police

## Retiree Health Actuarial Valuation Results as of September 30, 2008

**GRS**

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# Retiree Health Benefits

## The Funding Issue

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- ◆ 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



# Governmental Accounting Standards Board

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- ◆ 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 (approximately 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 (approximately 4%) – and the liabilities and ARC are much larger



# Governmental Accounting Standards Board

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- ◆ 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 toward meeting the ARC
  - ▶ Medicare Part D Retiree Drug Subsidy (RDS) payments received during the year also count as employer contributions toward meeting the ARC



# SPRS – GASB Compliant Valuation

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- ◆ Annual Expenditures for Retiree Health Care Benefits:

- ▶ FY 2008: \$29.7 million

- ◆ 2008 Potential Unfunded Accrued Liability and ARC:

	<u>Unfunded Liability</u>	<u>ARC - FY2009</u>
Full Actuarial Funding	\$571 million	\$45 million

Potential Unfunded Liability and ARC from September 2008 actuarial valuation  
Annual Expenditures from the SPRS 2008 Comprehensive Annual Financial Report



# SPRS – GASB Compliant Valuation Full Actuarial Funding

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◆ 2008 Potential Unfunded Accrued Liability and ARC:

	<u>Unfunded Liability</u>	<u>ARC - FY2009</u>
Full Actuarial Funding	\$571 million	\$ 45 million
Less Actual FY2008 Employer Contribution		<u>\$(29 million)</u>
Additional Employer Contribution to Fully Fund the ARC		<b>\$ 16 million</b>

- ◆ Lump sum of \$571 million would fully fund the 2008 unfunded liability
- ◆ Once fully funded, the annual employer contribution requirement decreases to the normal cost
- ◆ Employer normal cost is \$9.8 million in FY2009

Potential Unfunded Liability and ARC from September 2008 actuarial valuation

Actual FY2008 Employer Contribution from the SPRS 2008 Comprehensive Annual Financial Report



# SPRS – GASB Compliant Valuation

## Full Actuarial Funding vs. Cash Funding

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- ◆ 2008 Potential Unfunded Accrued Liability and ARC:

	<u>Unfunded Liability</u>	<u>ARC - FY2009</u>
Full Actuarial Funding	\$571 million	\$45 million
Cash Funding	\$963 million	\$64 million

- ◆ Lump sum of \$571 million would fully fund the 2008 unfunded liability (annual normal cost thereafter)
- ◆ The \$963 million 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
- ◆ \$392 million (\$963 less \$571) represents some of the lost investment income from not pre-funding

Potential Unfunded Liability and ARC from September 2008 GASB valuation



# SPRS – GASB Compliant Valuation

## Impact of Cash Funding Policy (Pay-go)

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- ◆ No investment income to help pay the costs
  - Higher liability reported, compared to full actuarial funding
- ◆ Reported liability on State's balance sheet
  - Page 75 of State of Michigan 2008 CAFR
  - Only 49.4% of ARC
  - \$29.9 million Net OPEB Obligation
    - This balance sheet liability will grow



# Circumstances That Would Increase Projected Costs

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- ◆ 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; the actual future contributions will depend on future per capita health cost increases (health inflation) \*
- ◆ Active member population decline (contribution rates as a percentage of payroll would increase)
- ◆ This is not a complete list

\* *Per capita costs are projected to increase 10.0% the first year, graded down to 3.5% in the twelfth and later years*



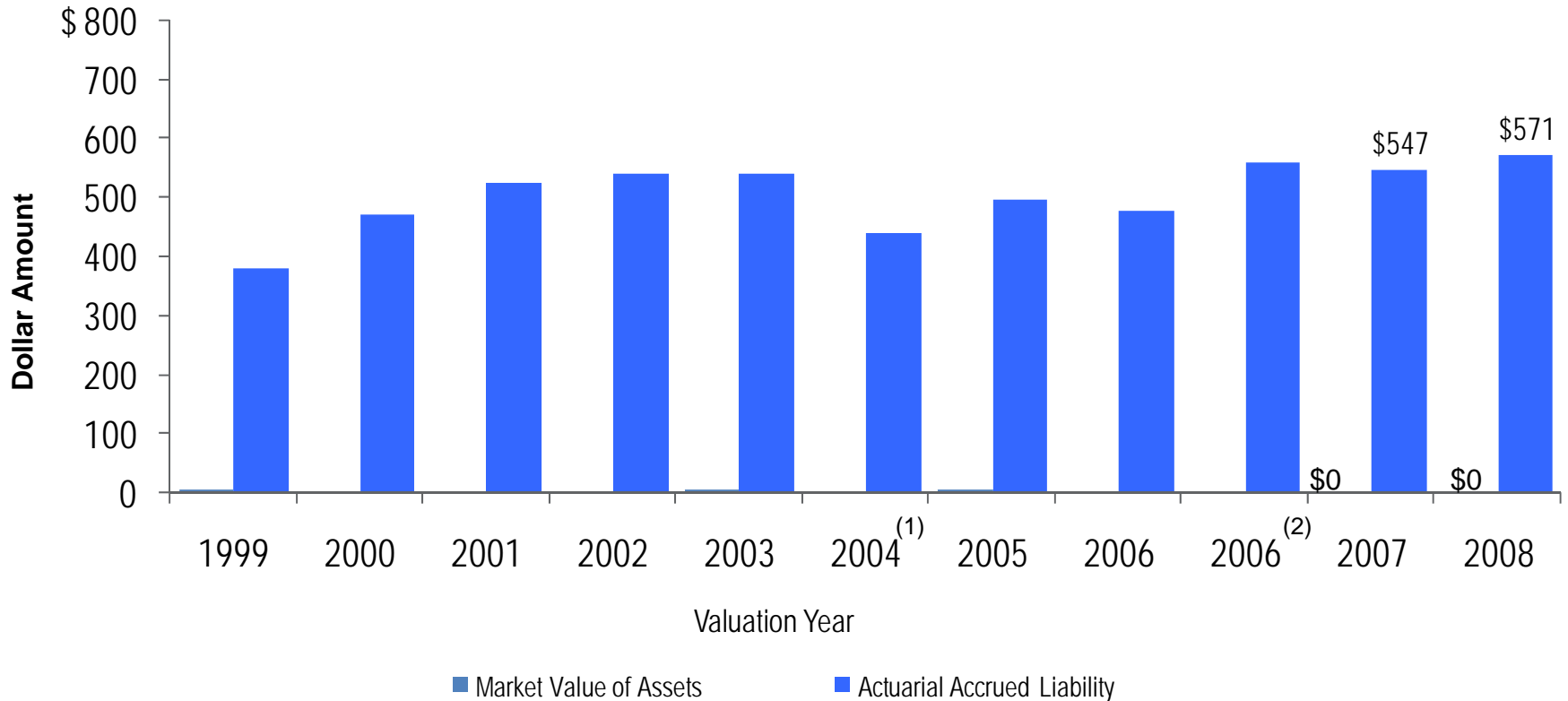
# Solutions and Observations

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- ◆ Strategic planning – an important tool to contain costs while delivering valuable benefits
- ◆ Plan for increases in employer health care contributions
- ◆ Partial pre-funding (more than cash funding, but less than GASB ARC) may protect against higher costs if experience is worse than projected


# Health Assets & Accrued Liabilities

## Full Actuarial Funding (Amounts in Millions)



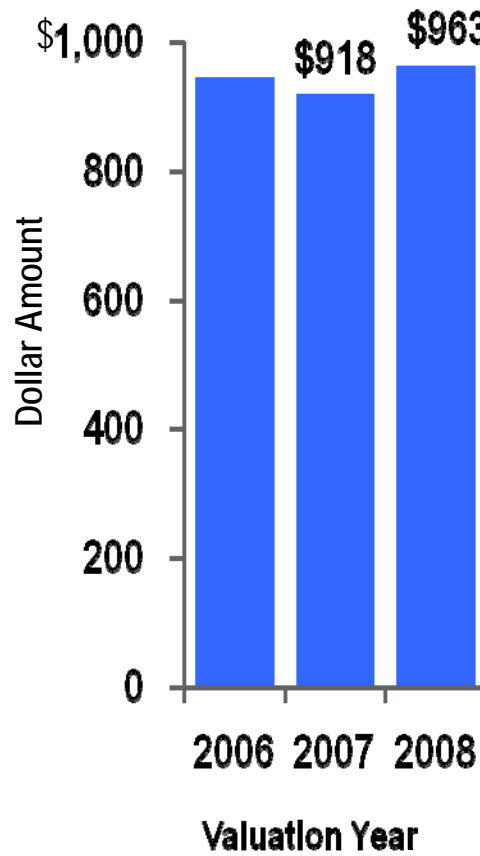
(1) Reflects assumption changes

(2) Reflects assumption changes and compliance with GASB Statements No. 43 and No. 45

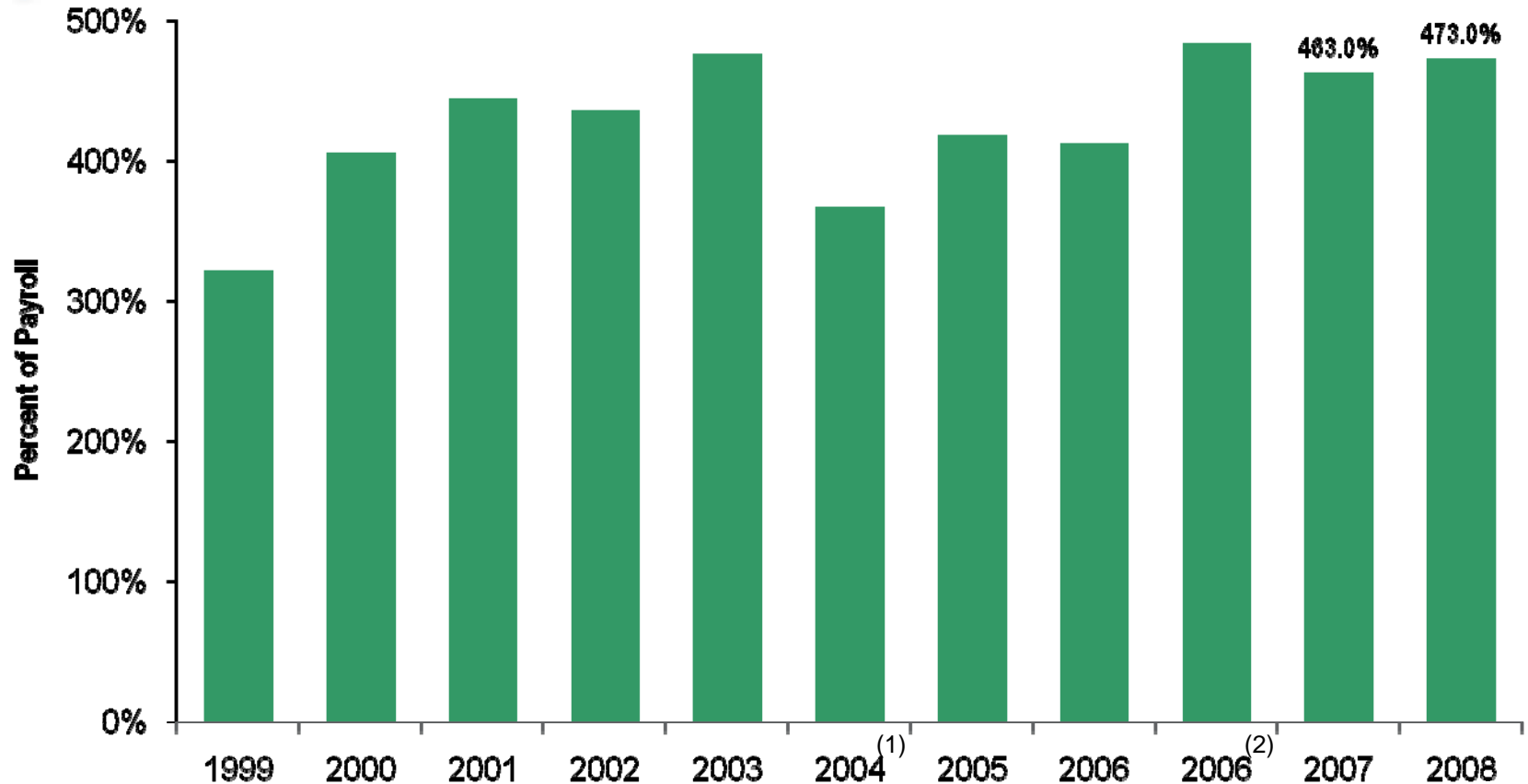


# Health Accrued Liabilities - Cash Funding (Pay-go) (Amounts in Millions)

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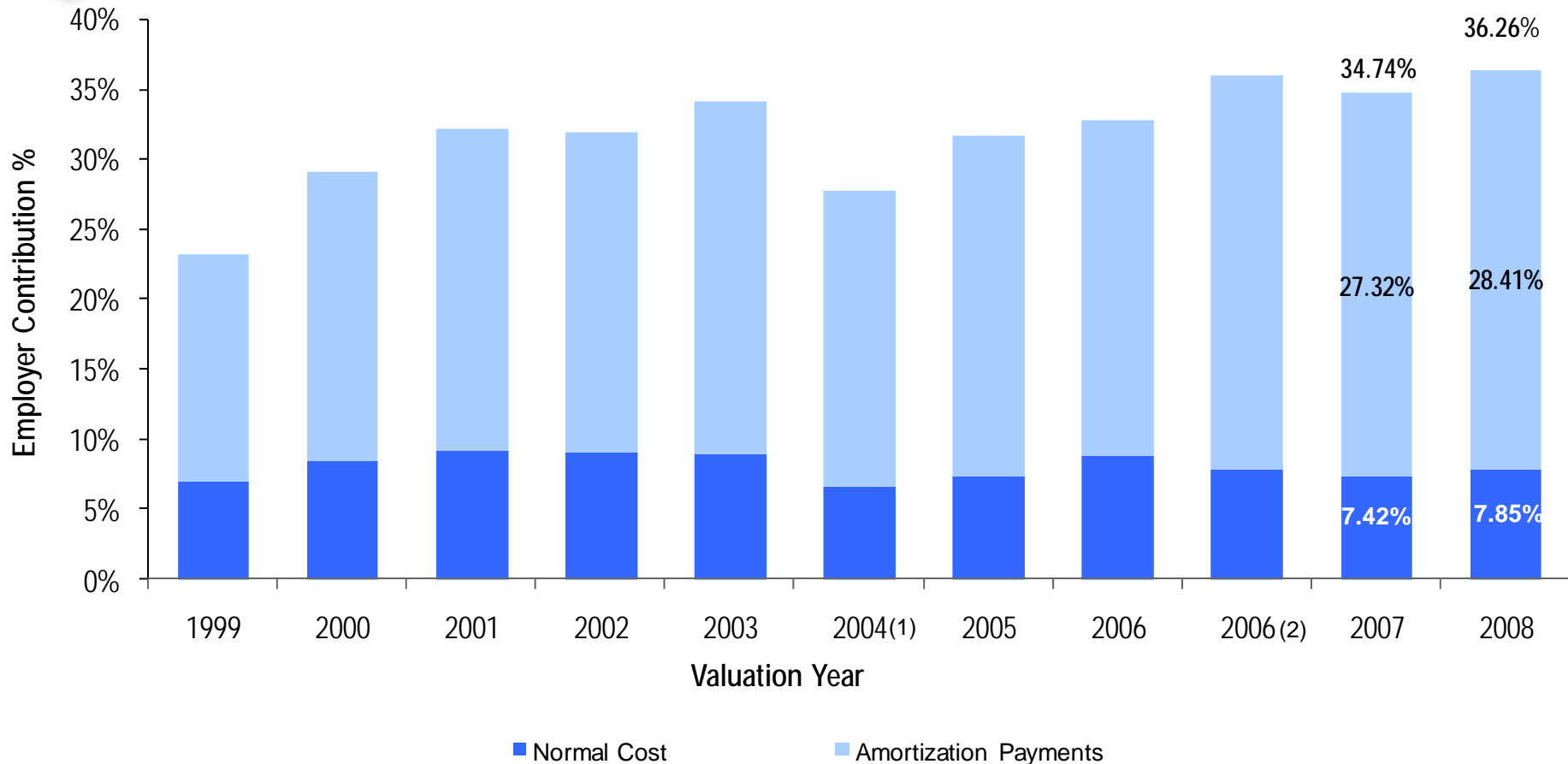
# Unfunded Accrued Liabilities as %'s of Payroll – Full Actuarial Funding



(1) Reflects assumption changes

(2) Reflects assumption changes and compliance with GASB Statements No. 43 and No. 45

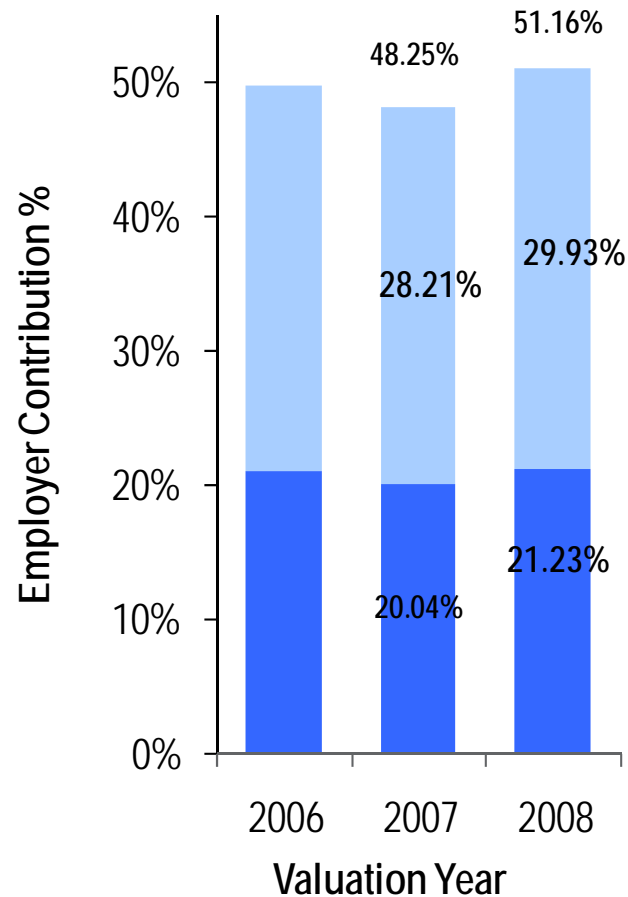
# Annual Required Contributions (ARC) as Percents of Payroll (Full Actuarial Funding)



(1) Reflects assumption changes

(2) Reflects assumption changes and compliance with GASB Statements No. 43 and No. 45

# Annual Required Contributions (ARC) as Percents of Payroll (Cash Funding – Pay-go)



■ Normal Cost    ■ Amortization Payments



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