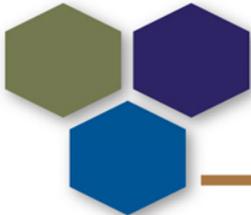


Michigan State Police

Retiree Health Actuarial Valuation Results as of September 30, 2012



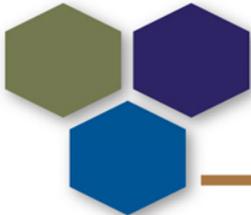
Gabriel Roeder Smith & Company
Consultants & Actuaries
www.gabrielroeder.com



Retiree Health Benefits

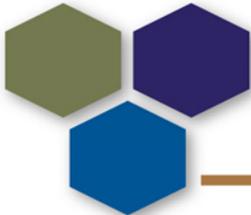
The Funding Issue

- ◆ Unlike pensions, health benefits have not been pre-funded
 - ▶ Most plan sponsors 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 been made only recently



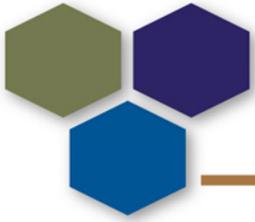
Governmental Accounting Standards Board

- ◆ 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 (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

- ◆ The reported liability and ARC depend on how the employer is funding the benefits
- ◆ If the employer has been funding more than the current benefits but less than the full actuarial contribution (partial pre-funding), the liabilities and ARC will lie somewhere between the pre-funding and 'Pay-go' funding results
- ◆ Existing employer contributions to pay the current year's 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

Full Actuarial Funding

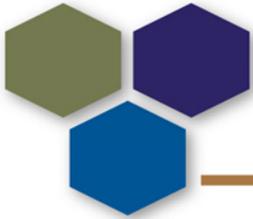
- ◆ Annual Expenditures for Retiree Health Care Benefits:

 - ▶ FY 2012: \$29.3 million

- ◆ 2012 Potential Unfunded Accrued Liability and ARC:

	<u>Unfunded Liability</u>	<u>ARC - FY2013</u>
Full Actuarial Funding	\$566 million	\$47 million

Potential Unfunded Liability and ARC from September 2012 actuarial valuation
Annual Expenditures from the 2012 SPRS Comprehensive Annual Financial Report



SPRS – GASB Compliant Valuation Full Actuarial Funding

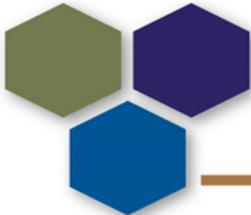
◆ 2012 Potential Unfunded Accrued Liability and ARC:

	<u>Liability</u>	<u>ARC - FY2013</u>
Full Actuarial Funding	\$566 million	\$ 47 million
Less Actual FY2012 Employer Contribution		<u>\$(47 million)</u>
Additional Employer Contribution to Fully Fund the ARC in FY2013		\$ 0

- ◆ Lump sum of \$566 million would fully fund the 2012 unfunded liability
- ◆ Once fully funded, the annual employer contribution requirement decreases to the normal cost
- ◆ Employer normal cost is \$8.5 million in FY2013

Potential Unfunded Liability and ARC from September 2012 actuarial valuation

Actual FY2012 Employer Contribution from the SPRS 2012 Comprehensive Annual Financial Report



SPRS – GASB Compliant Valuation

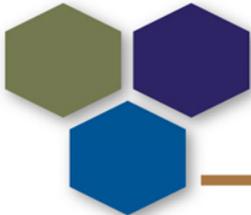
Full Actuarial Funding vs. Pay-go Funding

- ◆ 2012 Potential Unfunded Accrued Liability and ARC:

	<u>Unfunded Liability</u>	<u>ARC - FY2013</u>
Full Actuarial Funding	\$566 million	\$47 million
Pay-go Funding	\$969 million	\$67 million

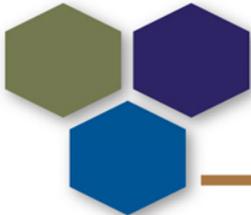
- ◆ Lump sum of \$566 million would fully fund the 2012 unfunded liability (annual normal cost payments thereafter)
- ◆ The \$969 million amount is the ARC for reporting and disclosure purposes (if pay-go funding is continued), and is not an amount that needs to be funded in a lump sum
- ◆ \$403 million (\$969 less \$566) represents some of the lost investment income from not pre-funding

Potential Unfunded Liability and ARC from September 2012 GASB valuation



SPRS – GASB Compliant Valuation Impact of Pay-go Funding Policy

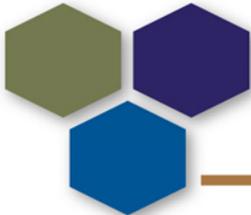
- ◆ No investment income to help pay the costs
 - ▶ Higher liability reported, compared to full actuarial funding
- ◆ Reported liability on State's balance sheet
 - ▶ Page 92 of State of Michigan 2012 CAFR
 - ▶ Only 69.6% of Annual OPEB Cost was contributed
 - ▶ \$149.1 million Net OPEB Obligation



Circumstances that Would Increase Projected Costs

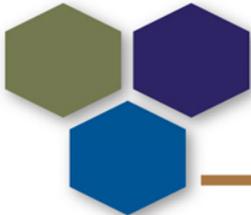
- ◆ Medicare funding reductions or cost shifting
- ◆ Unexpected new entrants into the retiree health plan (from health benefit cutbacks of other employers)
- ◆ Medical inflation worse than assumed; the actual future contributions will depend on future per capita health cost increases (health inflation) *
- ◆ 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 9.0% the first year, graded down to 3.5% in the tenth and later years*



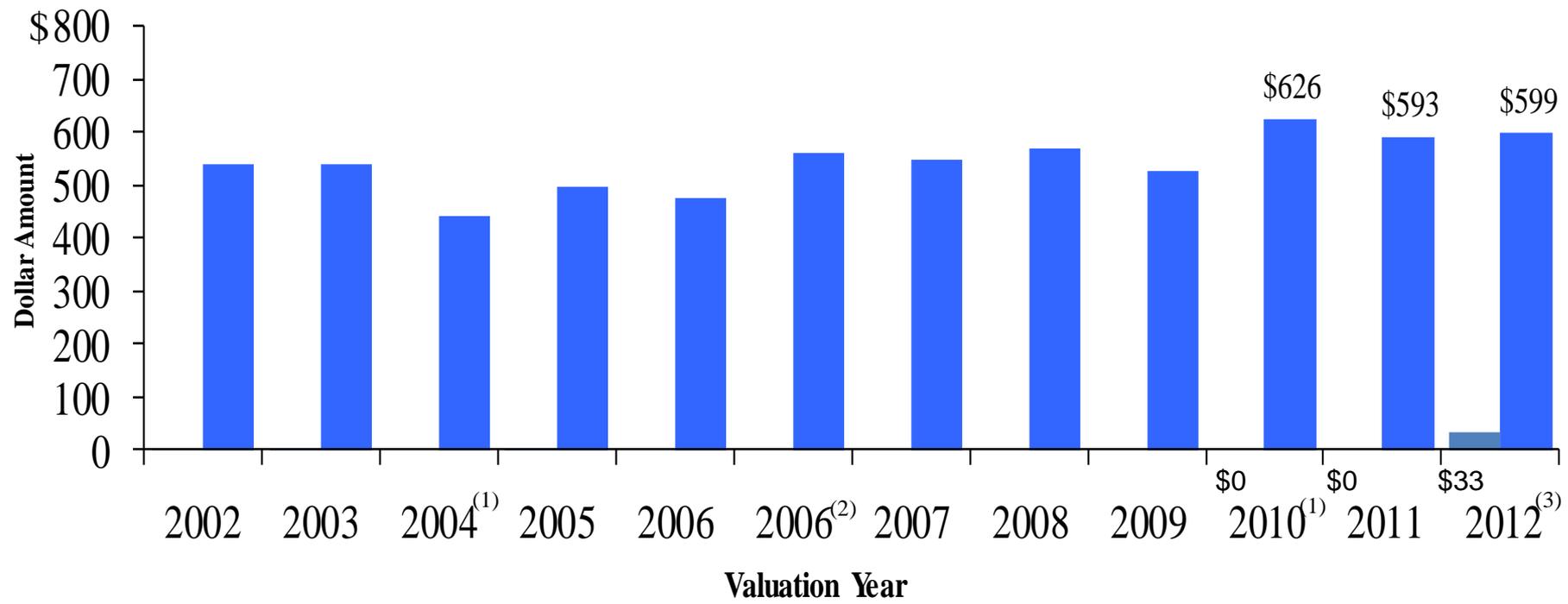
Solutions and Observations

- ◆ Strategic planning – an important tool to contain costs while delivering valuable benefits
 - ▶ Personal Health Care Fund (individual accounts)
- ◆ Plan for increases in employer health care contributions
- ◆ Partial pre-funding (more than ‘Pay-go’ 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)

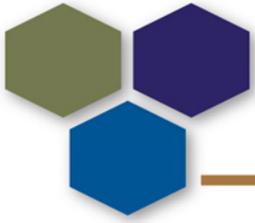


■ Market Value of Assets ■ Actuarial Accrued Liability

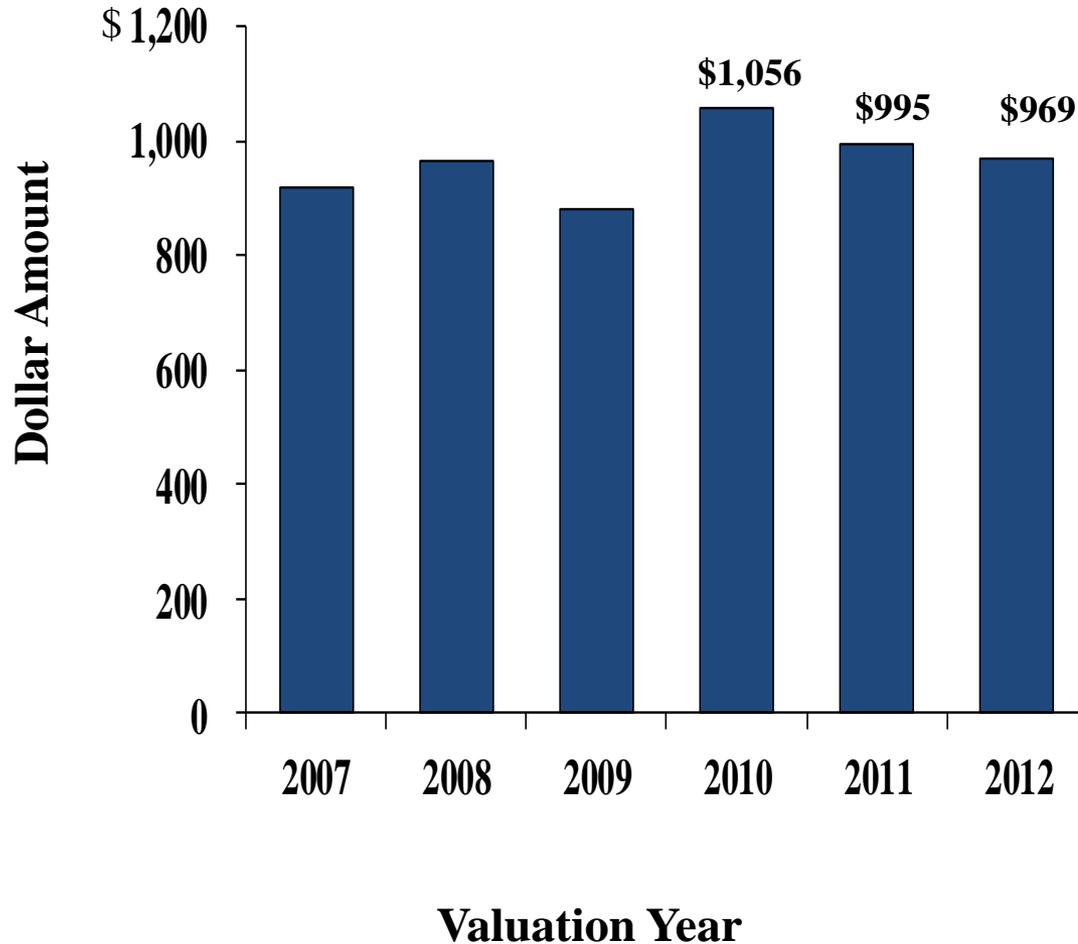
(1) Reflects assumption changes

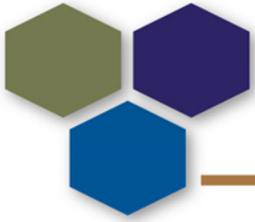
(2) Reflects assumption changes and compliance with GASB Statements No. 43 and No. 45

(3) Revised benefit provisions

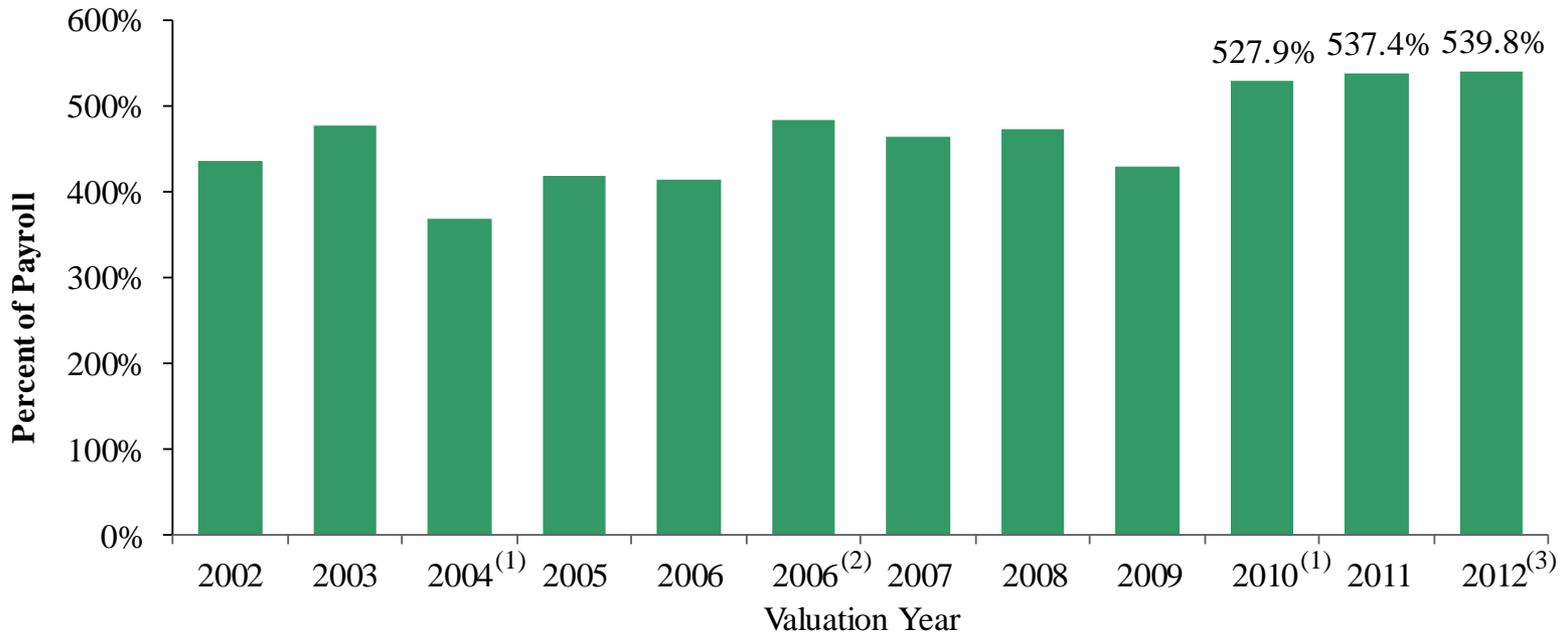


Health Accrued Liabilities – Pay-go Funding (Amounts in Millions)





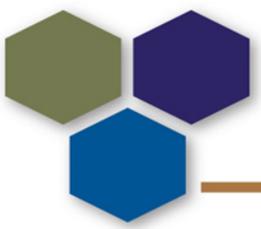
Unfunded Accrued Liabilities as %'s of Payroll – Full Actuarial Funding



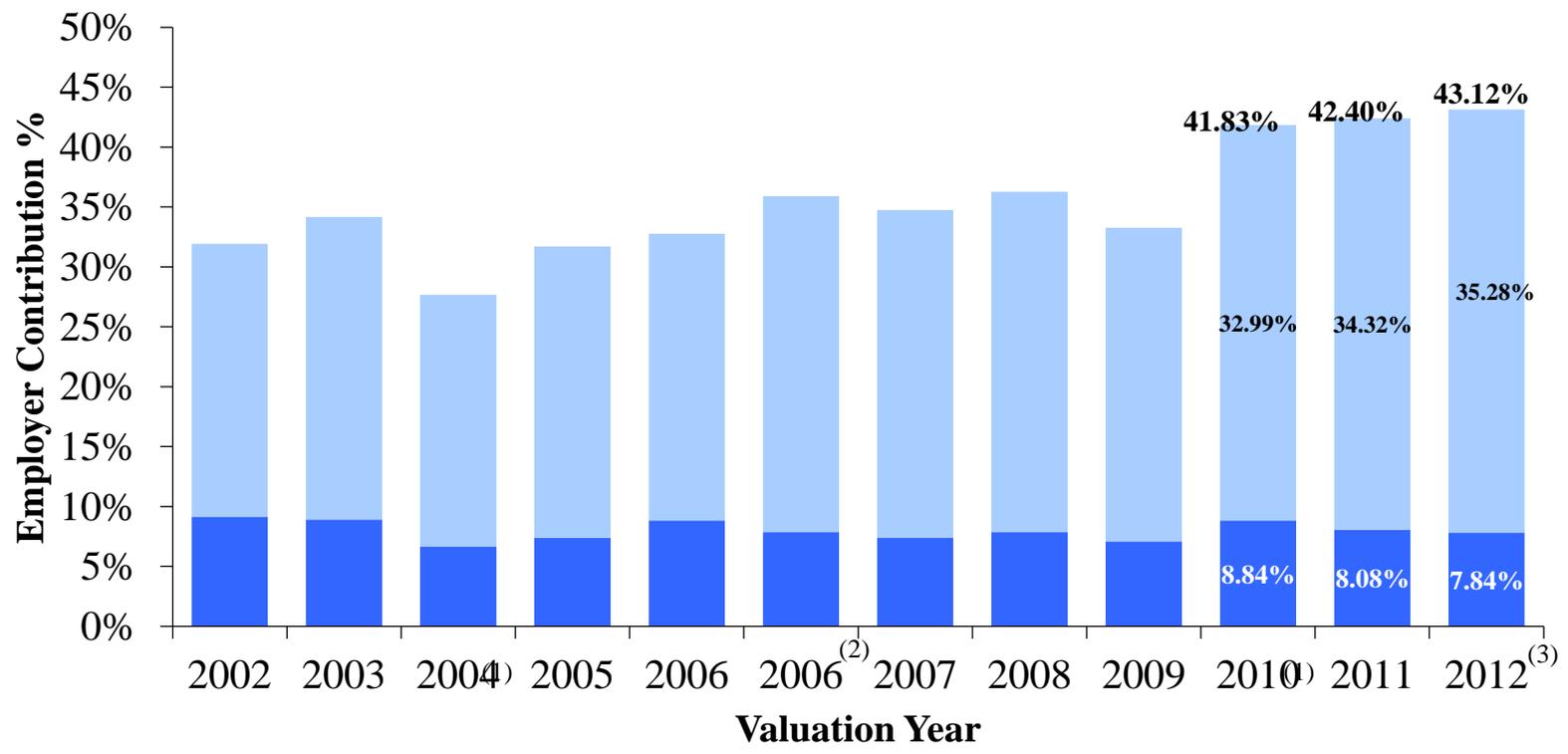
(1) Reflects assumption changes

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

(3) Revised benefit provisions



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



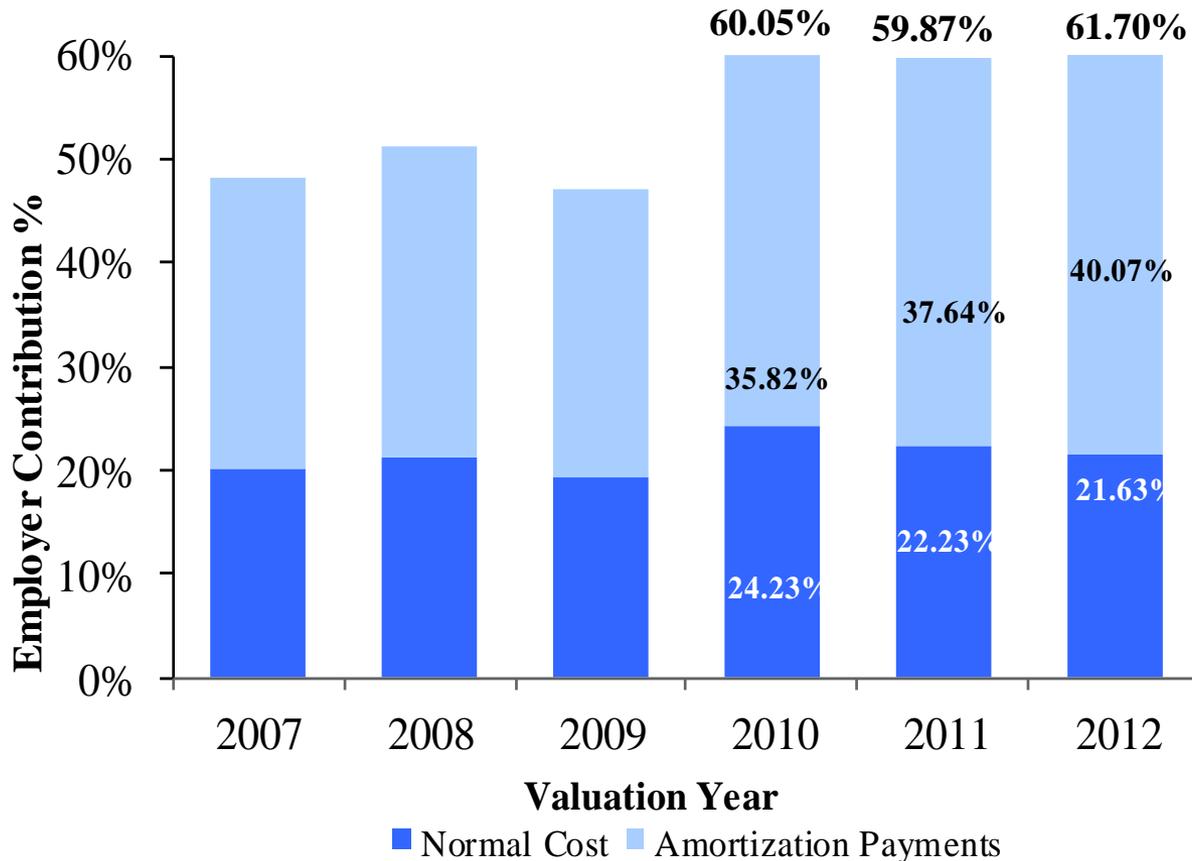
■ Normal Cost ■ Amortization Payments

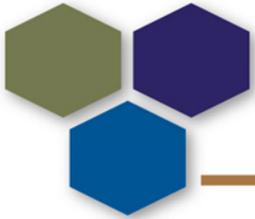
(1) Reflects assumption changes

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

(3) Revised benefit provisions

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





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