



# Michigan State Employees

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



# SERS – GASB Compliant Valuation

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- ◆ Annual Expenditures for Retiree Health Care Benefits:

- ▶ FY 2008: \$378 million

- ◆ 2008 Potential Unfunded Accrued Liability and ARC:

|                        | <u>Unfunded Liability</u> | <u>ARC - FY2009</u> |
|------------------------|---------------------------|---------------------|
| Full Actuarial Funding | \$8.3 billion             | \$663 million       |

Potential Unfunded Liability and ARC from September 2008 actuarial valuation.

Annual Expenditures from the SERS 2008 Comprehensive Annual Financial Report.



# SERS – GASB Compliant Valuation Full Actuarial Funding

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- ◆ 2008 Potential Unfunded Accrued Liability and ARC:

|   | <u>Unfunded<br/>Liability</u> | <u>ARC - FY2009</u>    |
|---|-------------------------------|------------------------|
| Full Actuarial Funding                                    | \$8.3 billion                 | \$ 663 million         |
| Less Actual FY2008 Employer<br>Contribution               |                               | <u>\$(342 million)</u> |
| Additional Employer Contribution<br>to Fully Fund the ARC |                               | <b>\$ 321 million</b>  |

- ◆ Lump sum of \$8.3 billion would fully fund the 2008 unfunded liability
- ◆ Once fully funded, the annual employer contribution requirement decreases to the normal cost
- ◆ Employer normal cost is \$147 million in FY2009

Potential Unfunded Liability and ARC from September 2008 actuarial valuation.

Actual FY2008 Employer Contribution from the SERS 2008 Comprehensive Annual Financial Report.



# SERS – 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 | \$8.3 billion             | \$663 million       |
| Cash Funding           | \$13.5 billion            | \$923 million       |

- ◆ Lump sum of \$8.3 billion would fully fund the 2008 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.
- ◆ \$5.2 billion (\$13.5 less \$8.3) represents some of the lost investment income from not pre-funding.

Potential Unfunded Liability and ARC from the September 2008 actuarial valuation.



# SERS – 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 38.9% of ARC
  - \$537.1 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% the first year, graded down to 3.5% in the twelfth and later years.*



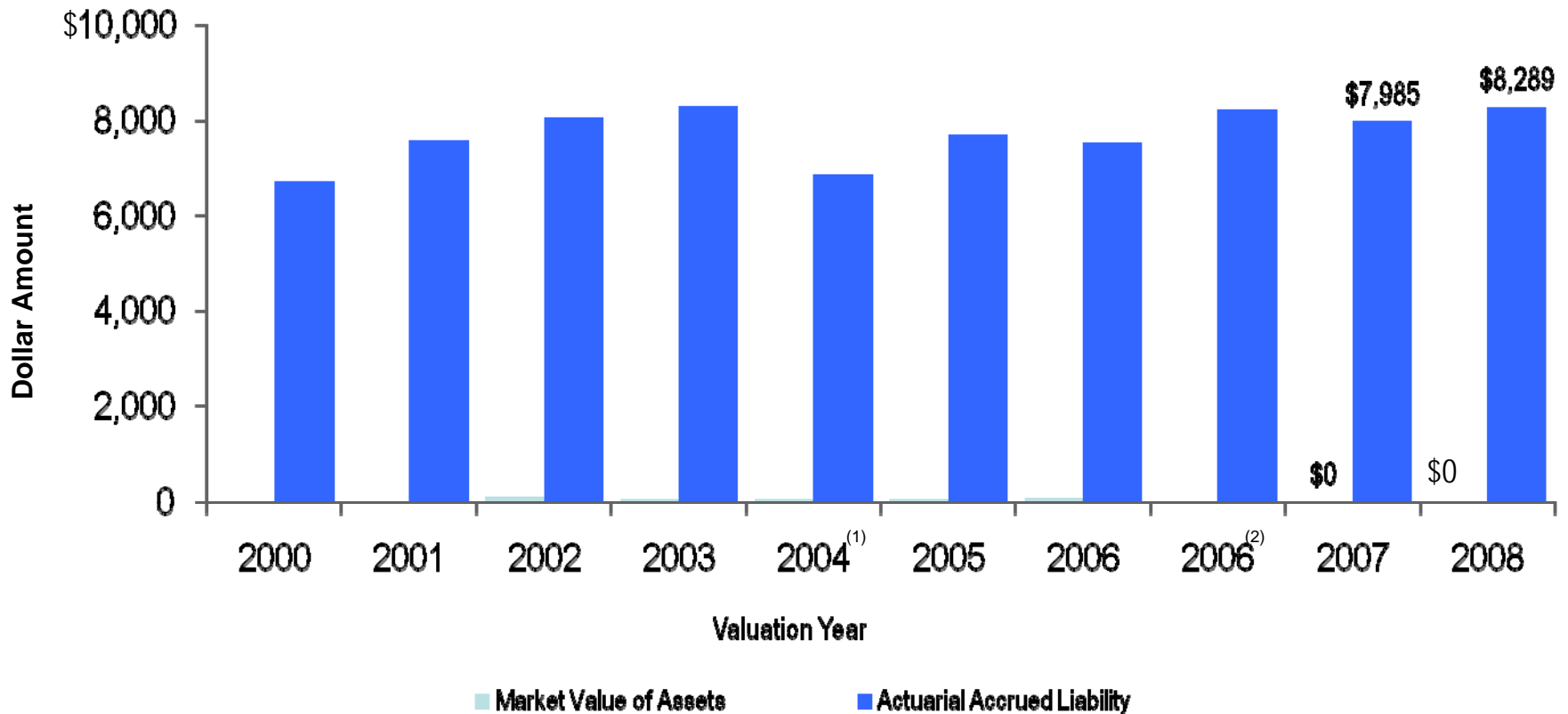
# Solutions and Observations

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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)



<sup>(1)</sup> Reflects assumption changes.

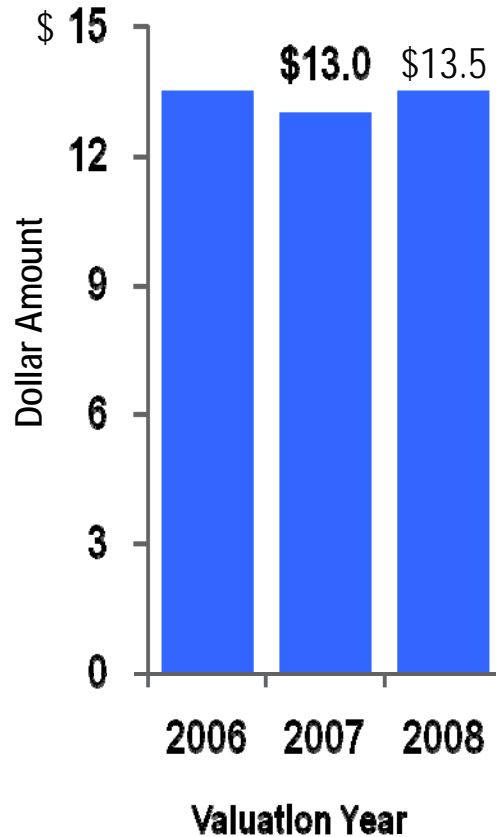
<sup>(2)</sup> Reflects assumption changes and compliance with GASB Statements No. 43 and No. 45.



# Health Accrued Liabilities

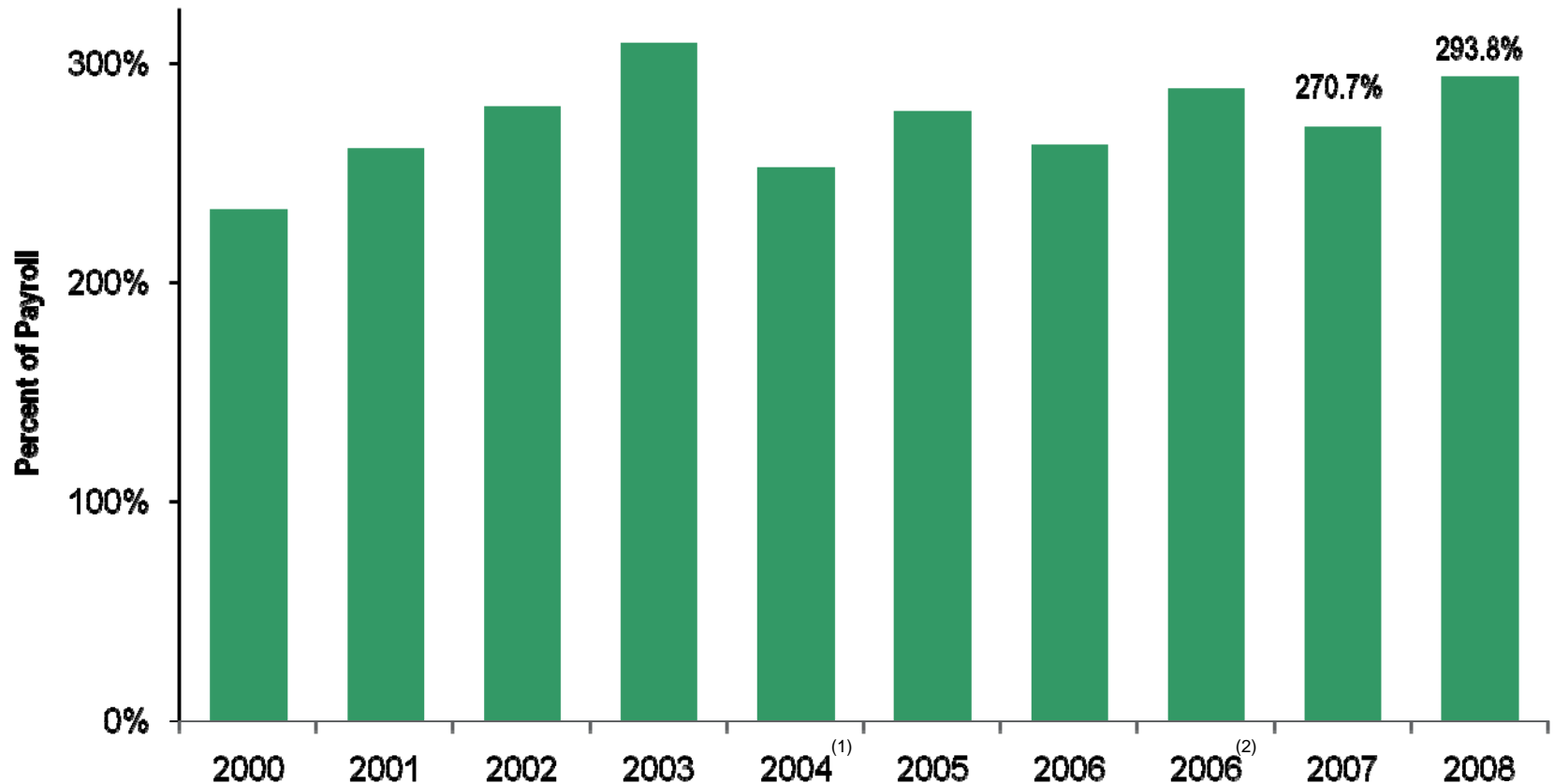
## Cash Funding (Pay-go) (Amounts in Billions)

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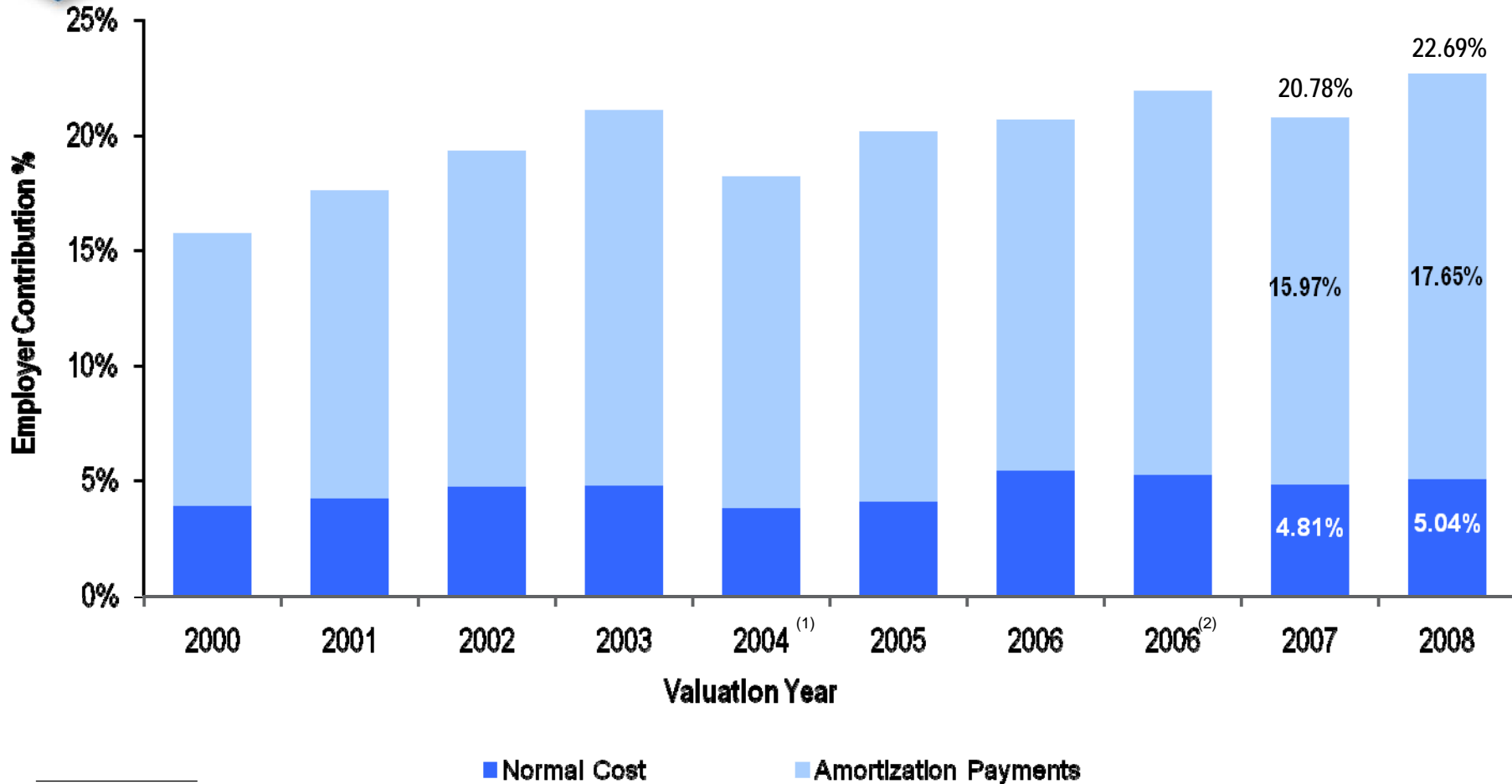
# Unfunded Accrued Liabilities as %'s of Payroll – Full Actuarial Funding



(1) Reflects assumption changes.

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

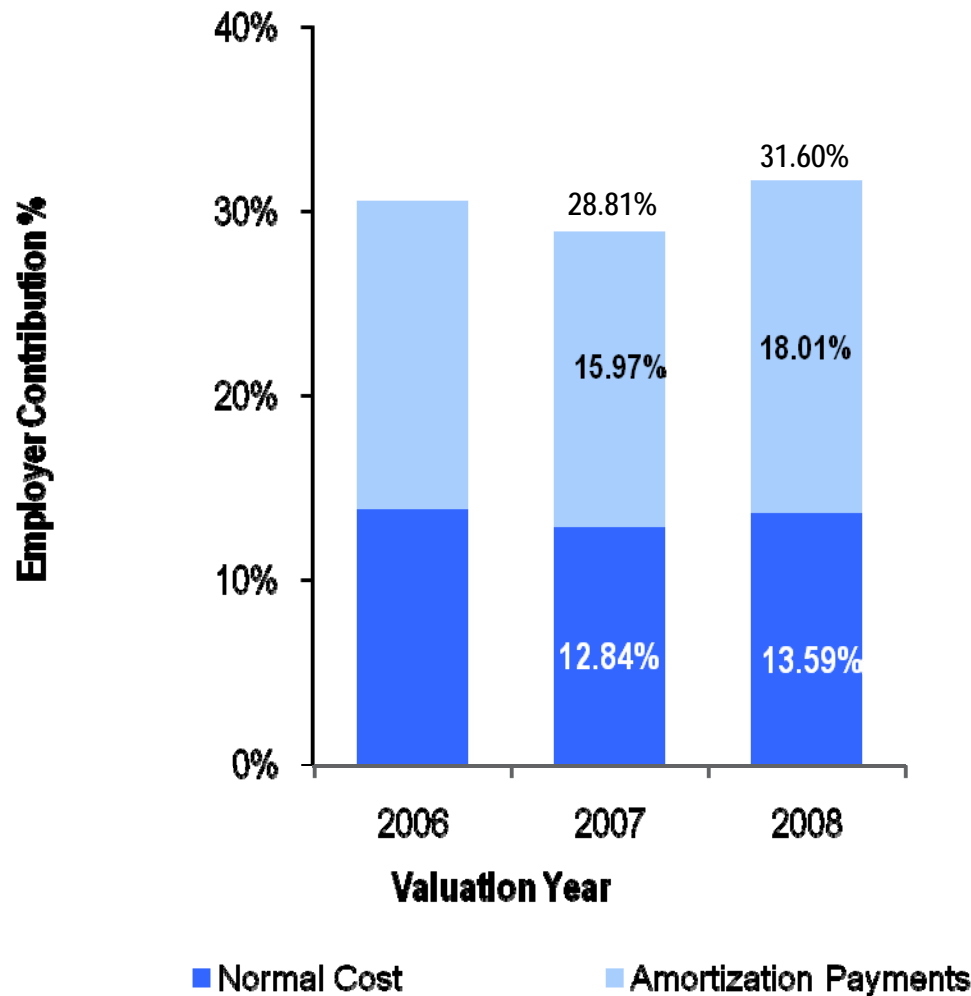
# Annual Required Contributions (ARC) as Percents of Payroll (Full Actuarial Funding)



(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)





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