



Michigan State Employees

Retiree Health Actuarial Valuation Results
as of September 30, 2009

GRS

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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



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 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

- ◆ Annual Expenditures for Retiree Health Care Benefits:

- ▶ FY 2009: \$413 million

- ◆ 2009 Potential Unfunded Accrued Liability and ARC:

	<u>Unfunded Liability</u>	<u>ARC - FY2010</u>
Full Actuarial Funding	\$7.8 billion	\$630 million

Potential Unfunded Liability and ARC from September 2009 actuarial valuation.

Annual Expenditures from the SERS 2009 Comprehensive Annual Financial Report.



SERS – GASB Compliant Valuation Full Actuarial Funding

◆ 2009 Potential Unfunded Accrued Liability and ARC:

	<u>Unfunded Liability</u>	<u>ARC - FY2010</u>
Full Actuarial Funding	\$7.8 billion	\$ 630 million
Less Actual FY2009 Employer Contribution		<u>\$(384 million)</u>
Additional Employer Contribution to Fully Fund the ARC		\$ 246 million

- ◆ Lump sum of \$7.8 billion would fully fund the 2009 unfunded liability
- ◆ Once fully funded, the annual employer contribution requirement decreases to the normal cost
- ◆ Employer normal cost is \$135 million in FY2010

Potential Unfunded Liability and ARC from September 2009 actuarial valuation.

Actual FY2009 Employer Contribution from the SERS 2009 Comprehensive Annual Financial Report.



SERS – GASB Compliant Valuation

Full Actuarial Funding vs. Cash Funding

- ◆ 2009 Potential Unfunded Accrued Liability and ARC:

	<u>Unfunded Liability</u>	<u>ARC - FY2010</u>
Full Actuarial Funding	\$ 7.8 billion	\$630 million
Cash Funding	\$12.6 billion	\$870 million

- ◆ Lump sum of \$7.8 billion would fully fund the 2009 unfunded liability (annual normal cost thereafter).
- ◆ The \$12.6 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.
- ◆ \$4.8 billion (\$12.6 less \$7.8) represents some of the lost investment income from not pre-funding.

Potential Unfunded Liability and ARC from the September 2009 actuarial valuation.



SERS – GASB Compliant Valuation Impact of Cash Funding Policy (Pay-go)

- ◆ 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 2009 CAFR
 - Only 41.6% of ARC
 - \$1,053.1 million Net OPEB Obligation
 - This balance sheet liability will grow



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% the first year, graded down to 3.5% in the twelfth and later years.*

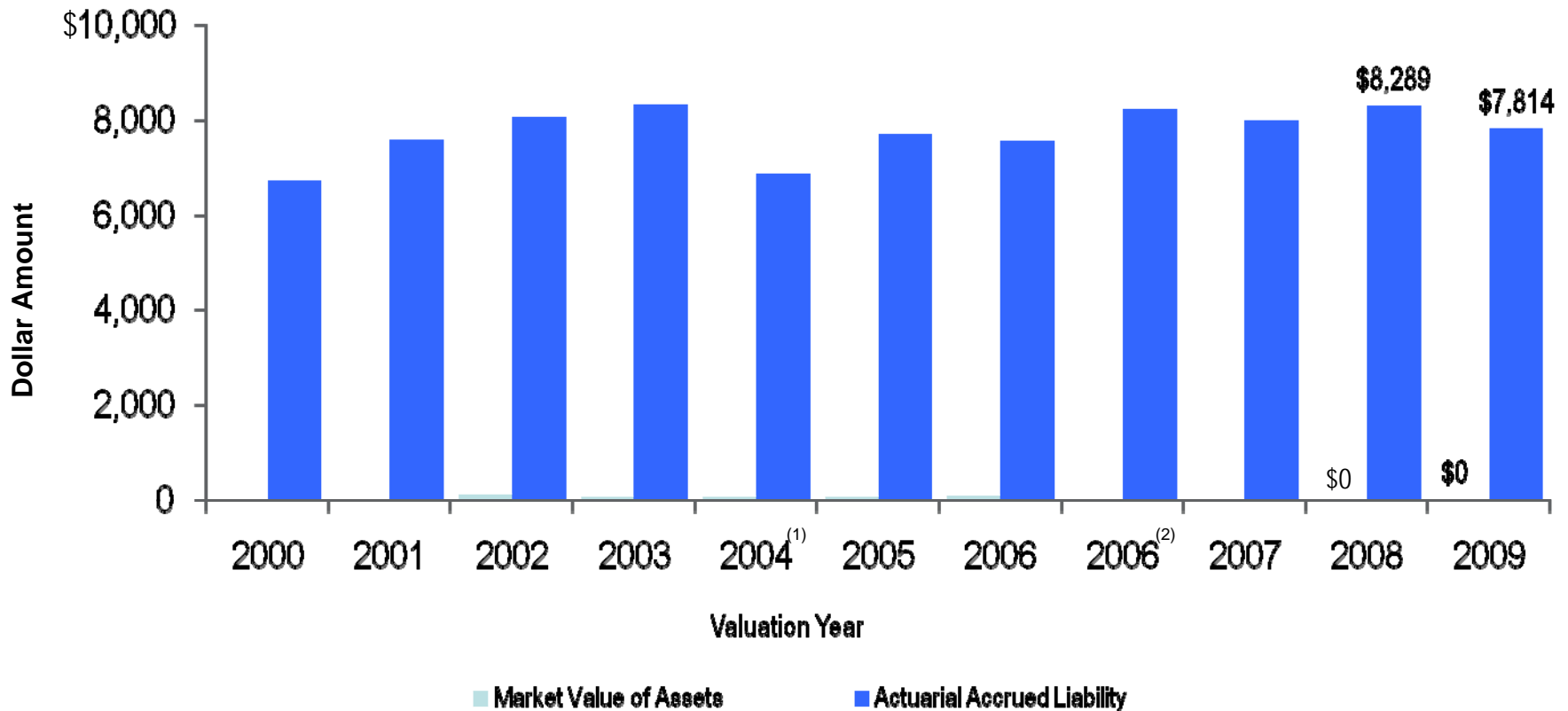


Solutions and Observations

- ◆ 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)

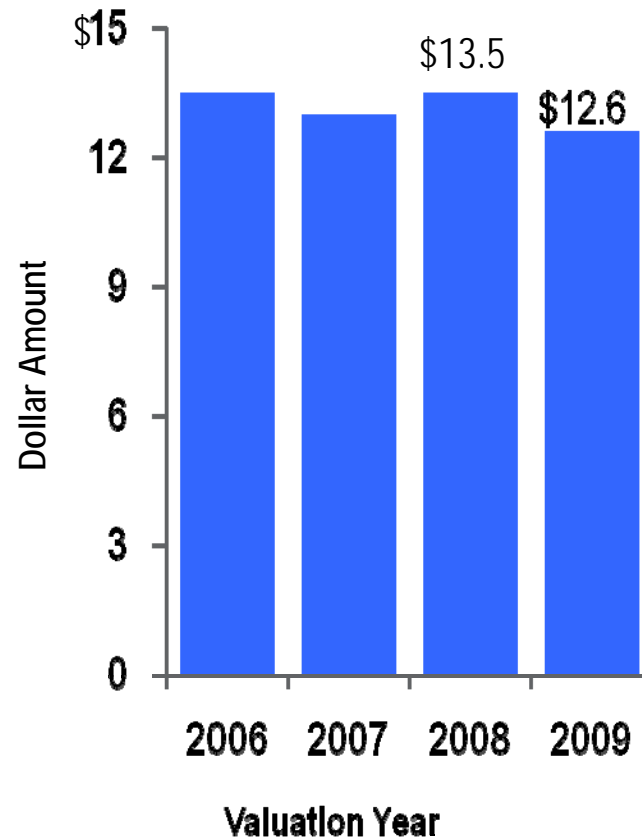


⁽¹⁾ Reflects assumption changes.

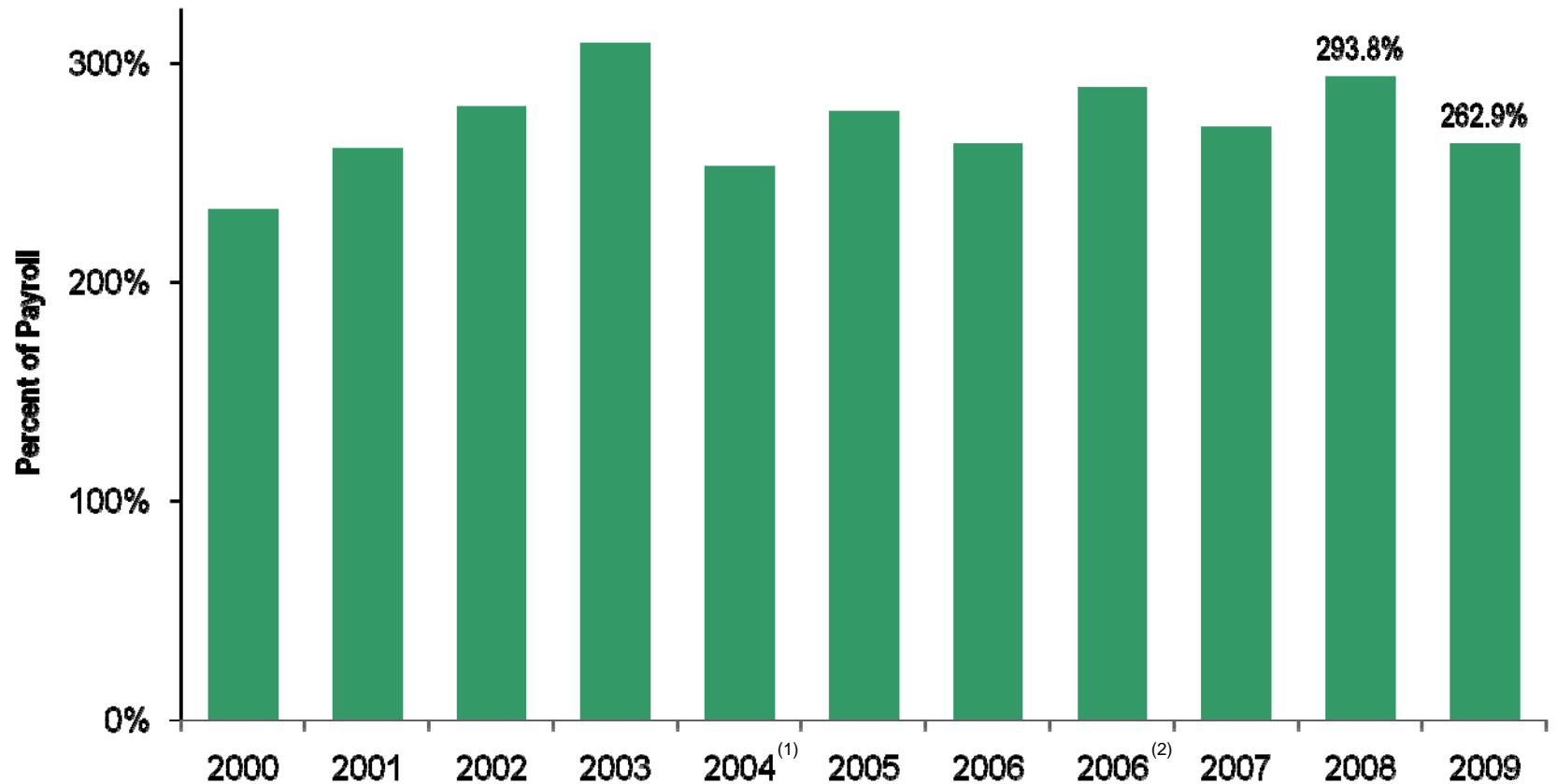
⁽²⁾ Reflects assumption changes and compliance with GASB Statements No. 43 and No. 45.

Health Accrued Liabilities

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



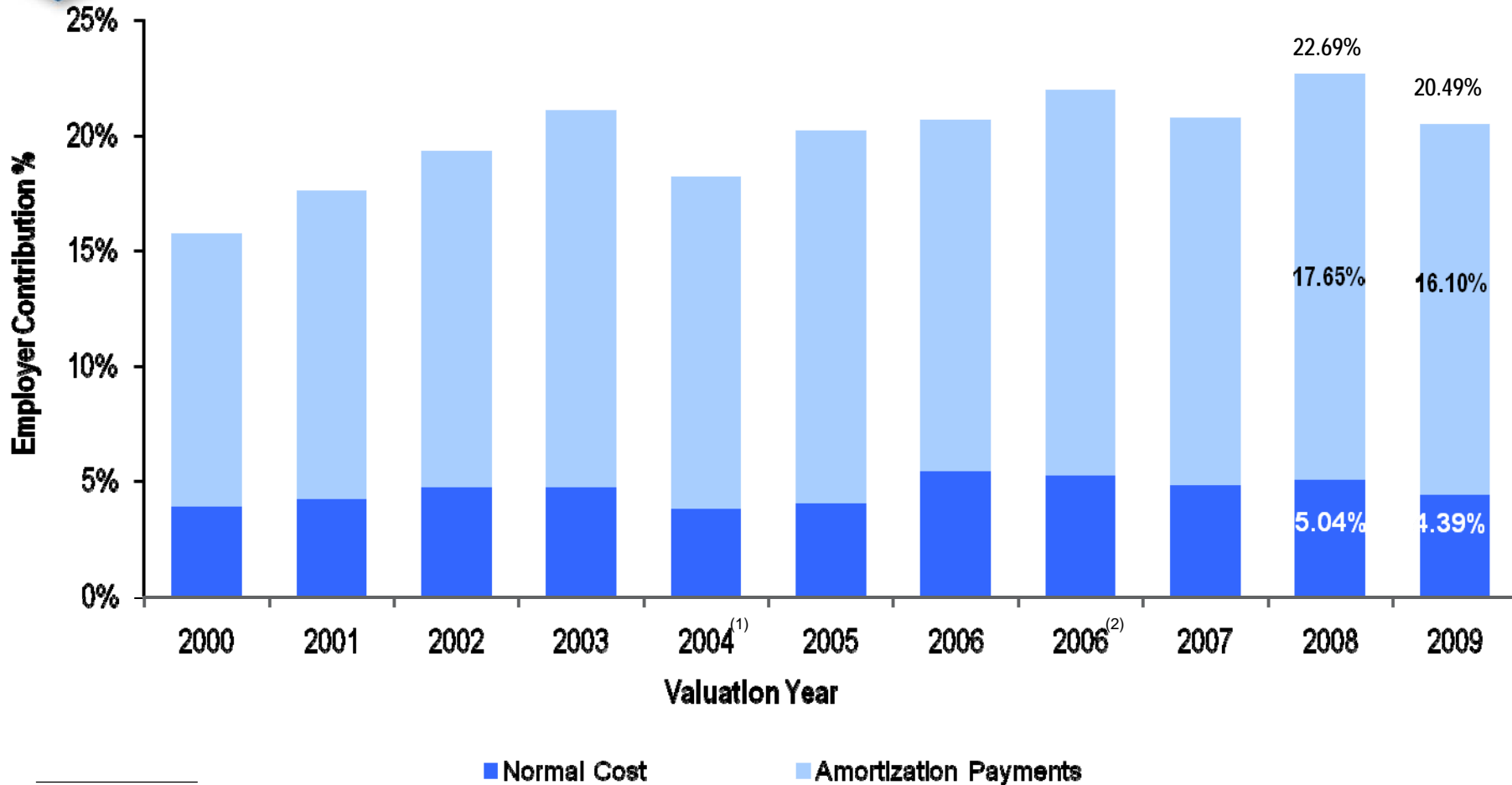
Unfunded Accrued Liabilities as %'s of Payroll – Full Actuarial Funding



(1) Reflects assumption changes.

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

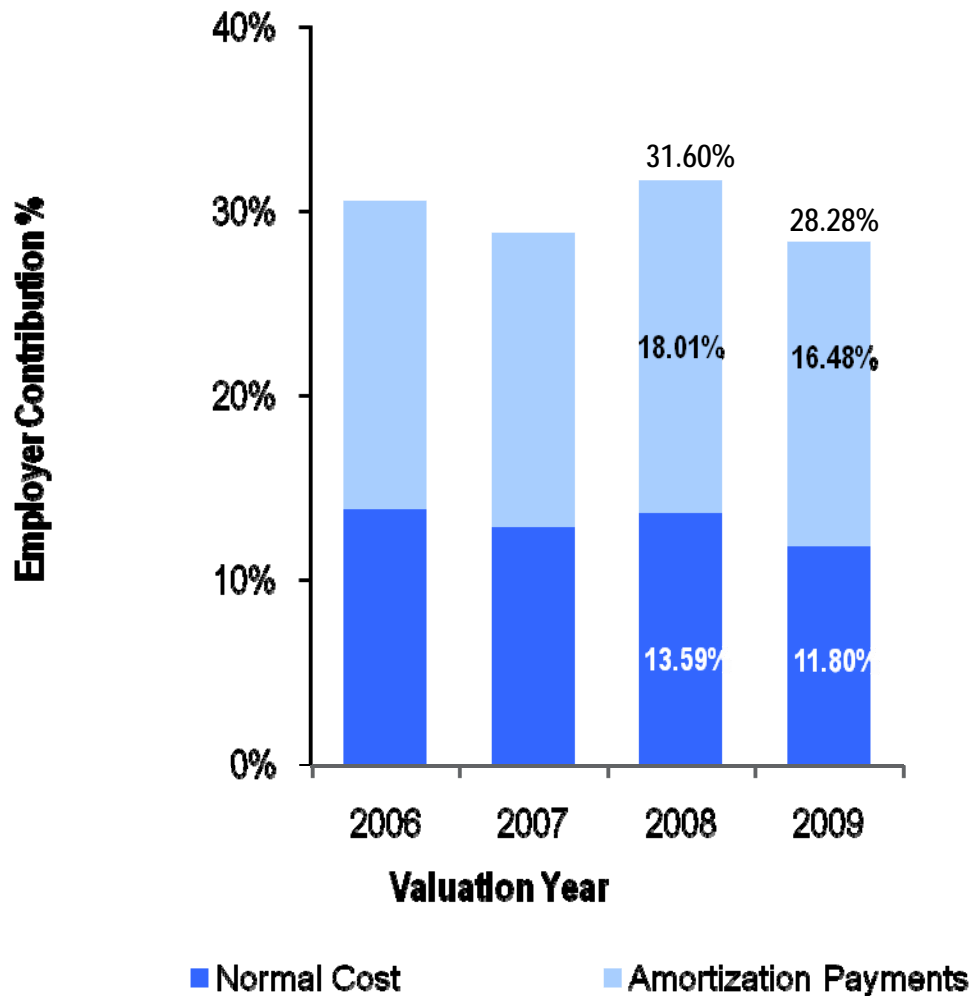
Annual Required Contributions (ARC) as Percents of Payroll (Full Actuarial Funding)



(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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