Michigan State Employees

Retiree Health Actuarial Valuation Results as of September 30, 2010

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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

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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

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SERS – GASB Compliant Valuation

- Annual Expenditures for Retiree Health Care Benefits:
  - FY 2010: $346 million

- 2010 Potential Unfunded Accrued Liability and ARC:

	Unfunded Liability	ARC - FY2011
Full Actuarial Funding	$9.1 billion	$736 million

Potential Unfunded Liability and ARC from September 2010 actuarial valuation.
Annual Expenditures from the SERS 2010 Comprehensive Annual Financial Report.

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SERS – GASB Compliant Valuation Full Actuarial Funding

- 2010 Potential Unfunded Accrued Liability and ARC:

	Unfunded Liability	ARC - FY2011
Full Actuarial Funding	$9.1 billion	$ 736 million
Less Actual FY2010 Employer Contribution		$(387 million)
Additional Employer Contribution to Fully Fund the ARC		**$ 349 million**

- Lump sum of $9.1 billion would fully fund the 2010 unfunded liability
- Once fully funded, the annual employer contribution requirement decreases to the normal cost
- Employer normal cost is $150 million in FY2011

Potential Unfunded Liability and ARC from September 2010 actuarial valuation.

Actual FY2010 Employer Contribution from the SERS 2010 Comprehensive Annual Financial Report.

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

- 2010 Potential Unfunded Accrued Liability and ARC:

	Unfunded Liability	ARC - FY2011
Full Actuarial Funding	$ 9.1 billion	$ 736 million
Cash Funding	$14.7 billion	$1,020 million

- Lump sum of $9.1 billion would fully fund the 2010 unfunded liability (annual normal cost thereafter).
- The $14.7 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.
- $5.6 billion ($14.7 less $9.1) represents some of the lost investment income from not pre-funding.

Potential Unfunded Liability and ARC from the September 2010 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 87 of State of Michigan 2010 CAFR
  - Only 44.5% of Annual OPEB Cost was contributed
  - $1,535.7 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.*

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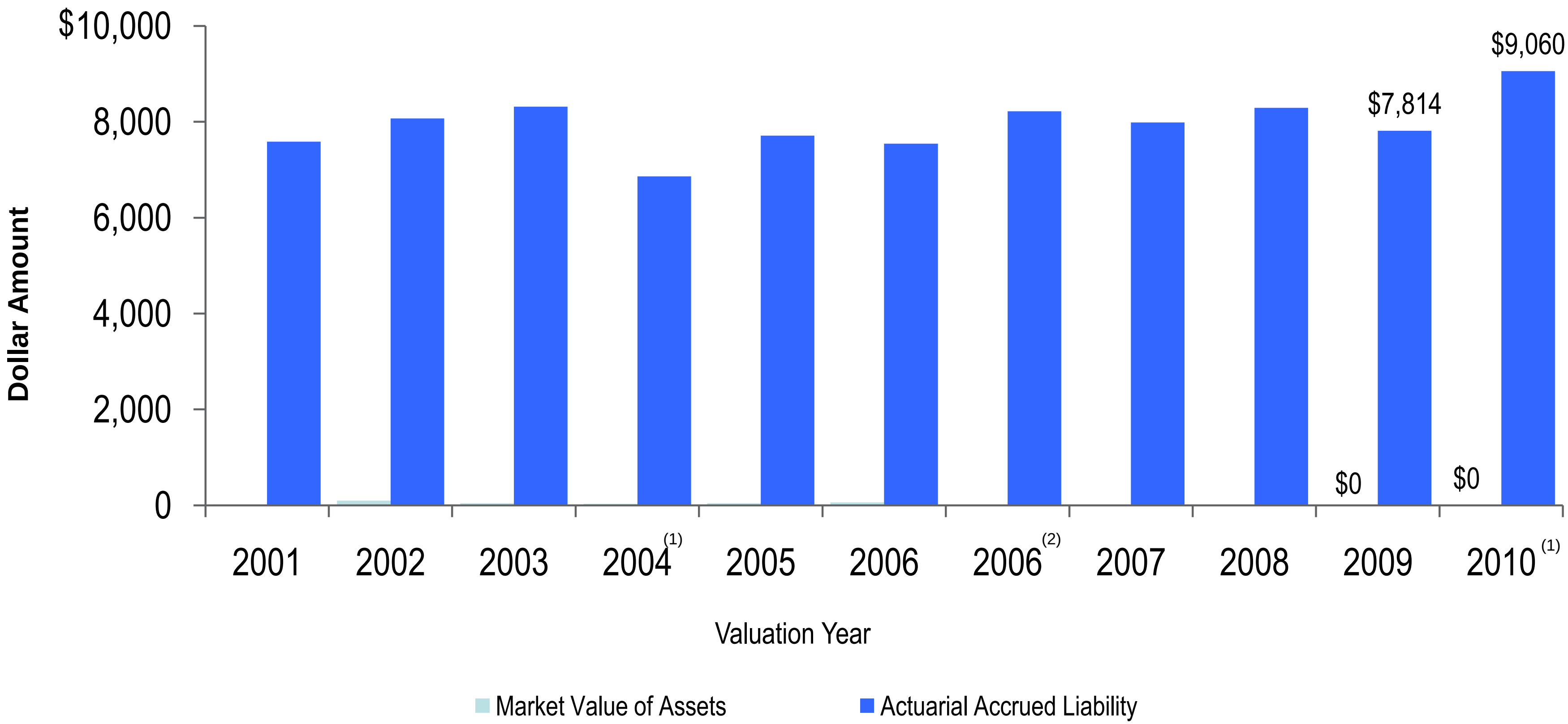
Solutions and Observations

- 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.

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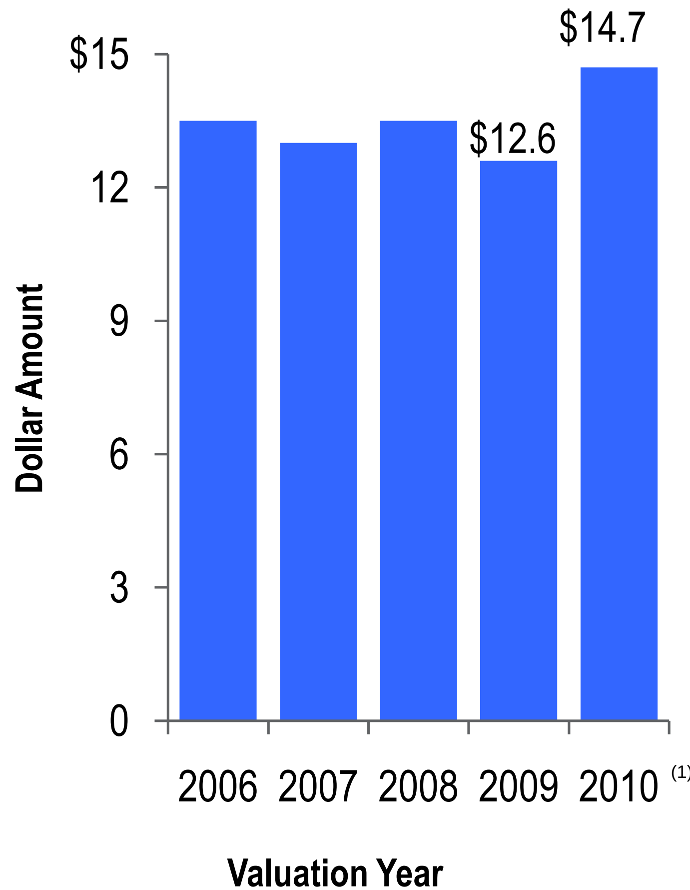
Health Accrued Liabilities
Cash Funding (Pay-go) (Amounts in Billions)



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(1) Reflects assumption changes.

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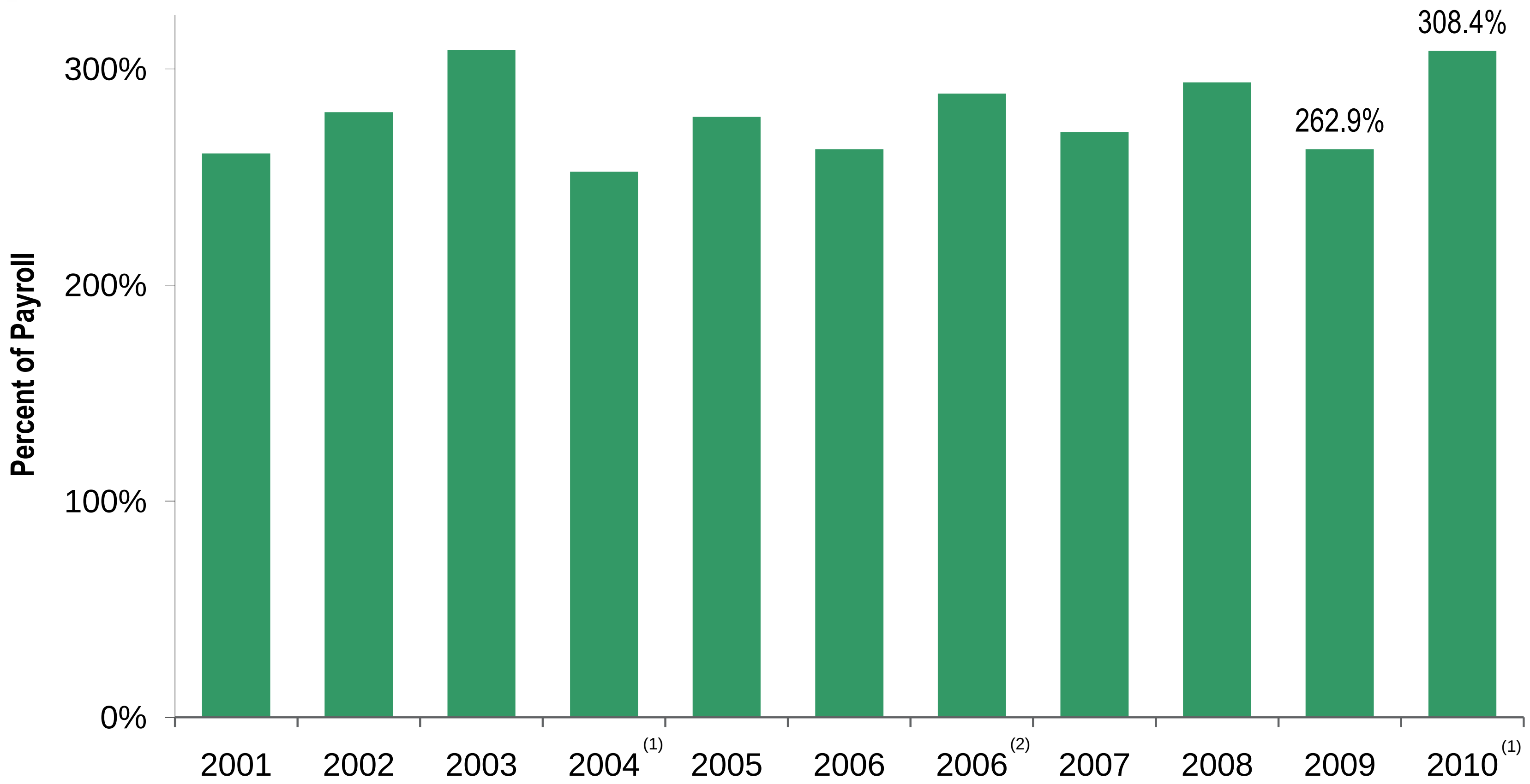
Unfunded Accrued Liabilities as %'s of Payroll – Full Actuarial Funding



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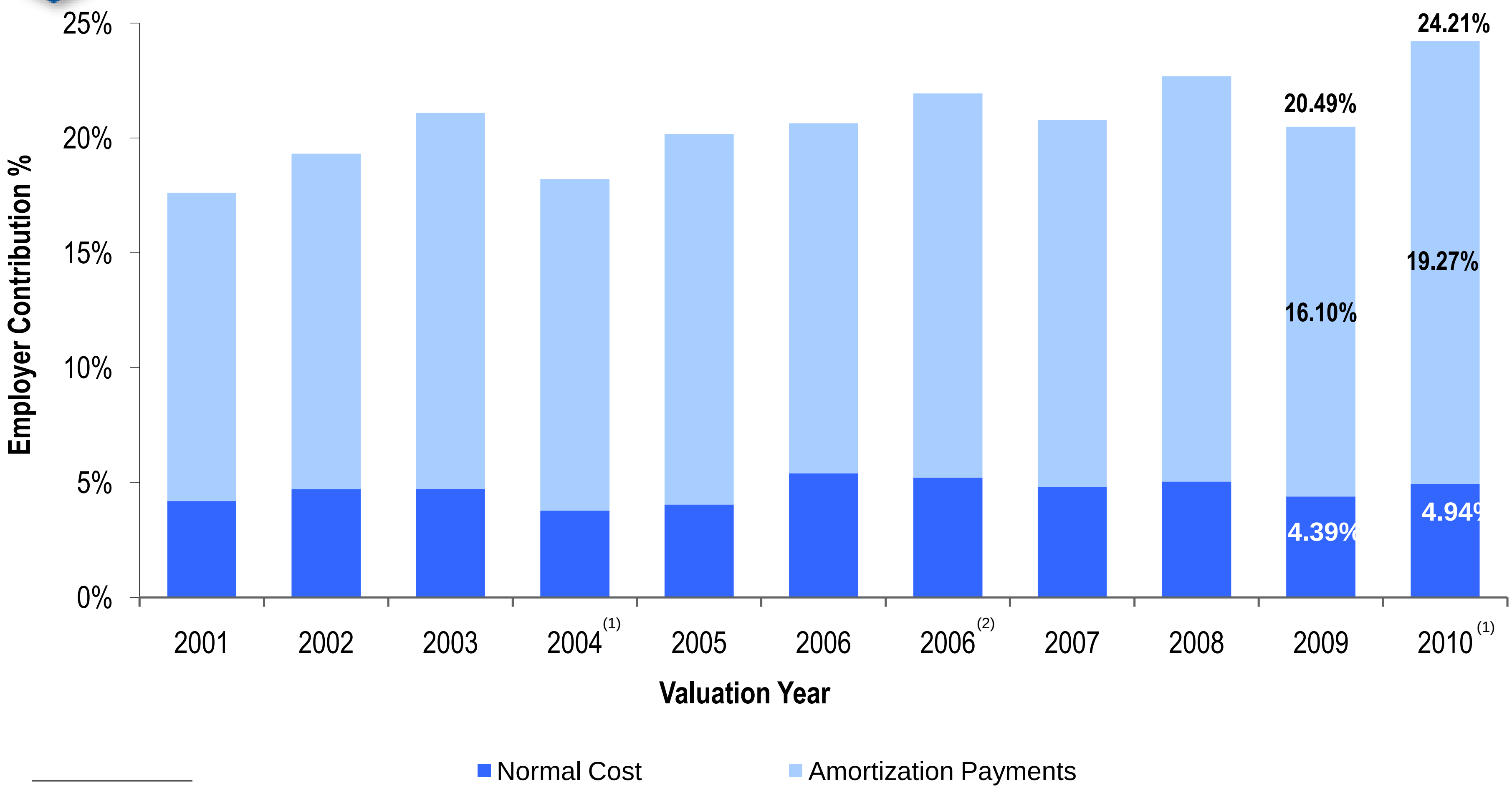
Annual Required Contributions (ARC) as Percents of Payroll (Full Actuarial Funding)



(1) Reflects assumption changes.

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

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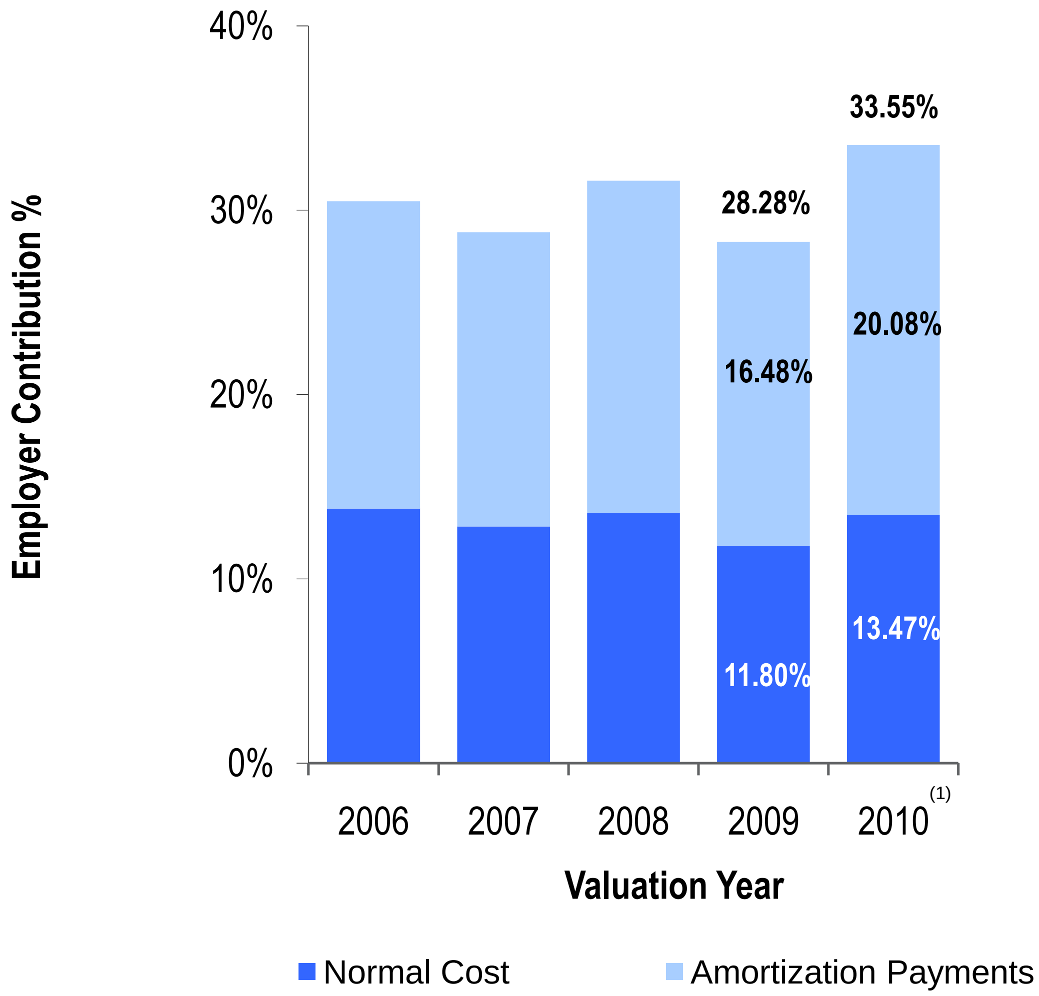
Annual Required Contributions (ARC) as Percents of Payroll (Cash Funding – Pay-go)



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