Employee Fringe Benefit Issues for Consideration

2012 General Session

House Appropriations Committee Retreat

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Overview

- ✓ Calculation of VRS Rates for 2012-14 Biennium
- ○ APA Review of State Employee Health Insurance Fund

Virginia Retirement System

- Article X, Section 11 of the Constitution of Virginia states “The General Assembly shall maintain a retirement system for state employees and employees of participating political subdivisions and school districts.”
  - Requires the system to be funded using methods consistent with generally accepted actuarial principles
- The VRS calculates rates every 2 years, prior to the initial development of an upcoming biennial budget, and forwards their recommendations to the Governor and the General Assembly for consideration

Rate Setting Methodology

- Actuarial rates are set based on a “snapshot” of the system as of June 30
- Calculations are based on the actuarial value of the fund as opposed to the June 30 market value of the fund to mitigate significant swings in contribution rates
    - Actuarial value is calculated by realizing investment gains and losses using a 5 year smoothing method
- Actuarial value tends to be higher than market value during times of recession and lower than market value during times of rapid growth
    - For June 2011 valuation the actuarial value is slightly higher than the market value (within 3%)

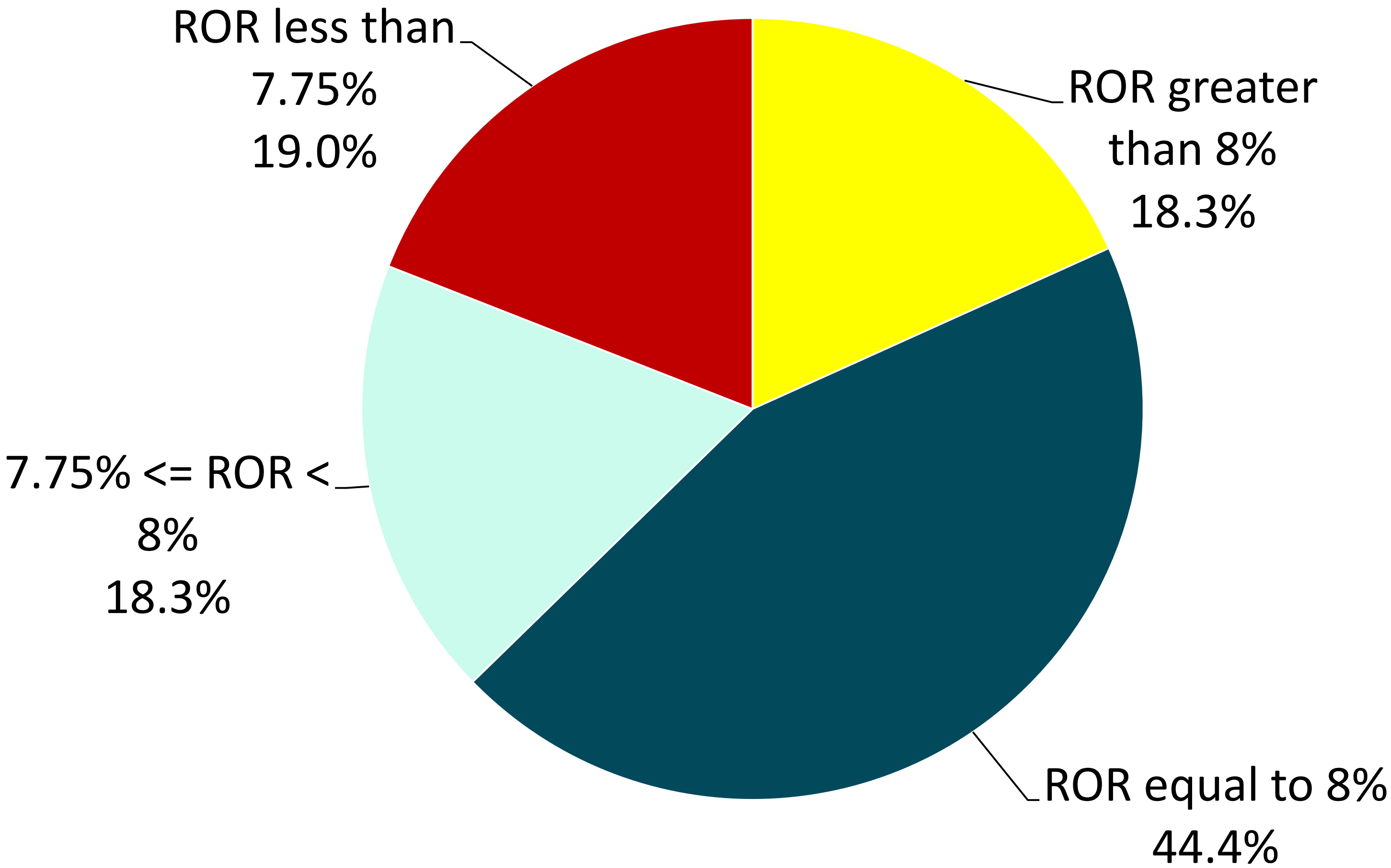
Policy Assumptions Used by VRS Board in Recommending Rates

- Over the past 15 years the Board has made incremental changes to certain policy assumptions
  - Decreased the assumed rate of return (ROR) from 8.0% to 7.5% in 2005
  - Incrementally decreased the amortization period from 30 years to 20 years from 1996 through 2006
  - In 2010 the Board reduced the assumed rate of return from 7.5% to 7.0%
- The Board recommended rates for the 2012-2014 biennium are based a 7.0% Rate of Return, 2.5% COLA, and 30 year amortization

Policy Assumptions Adopted by the General Assembly & Governor

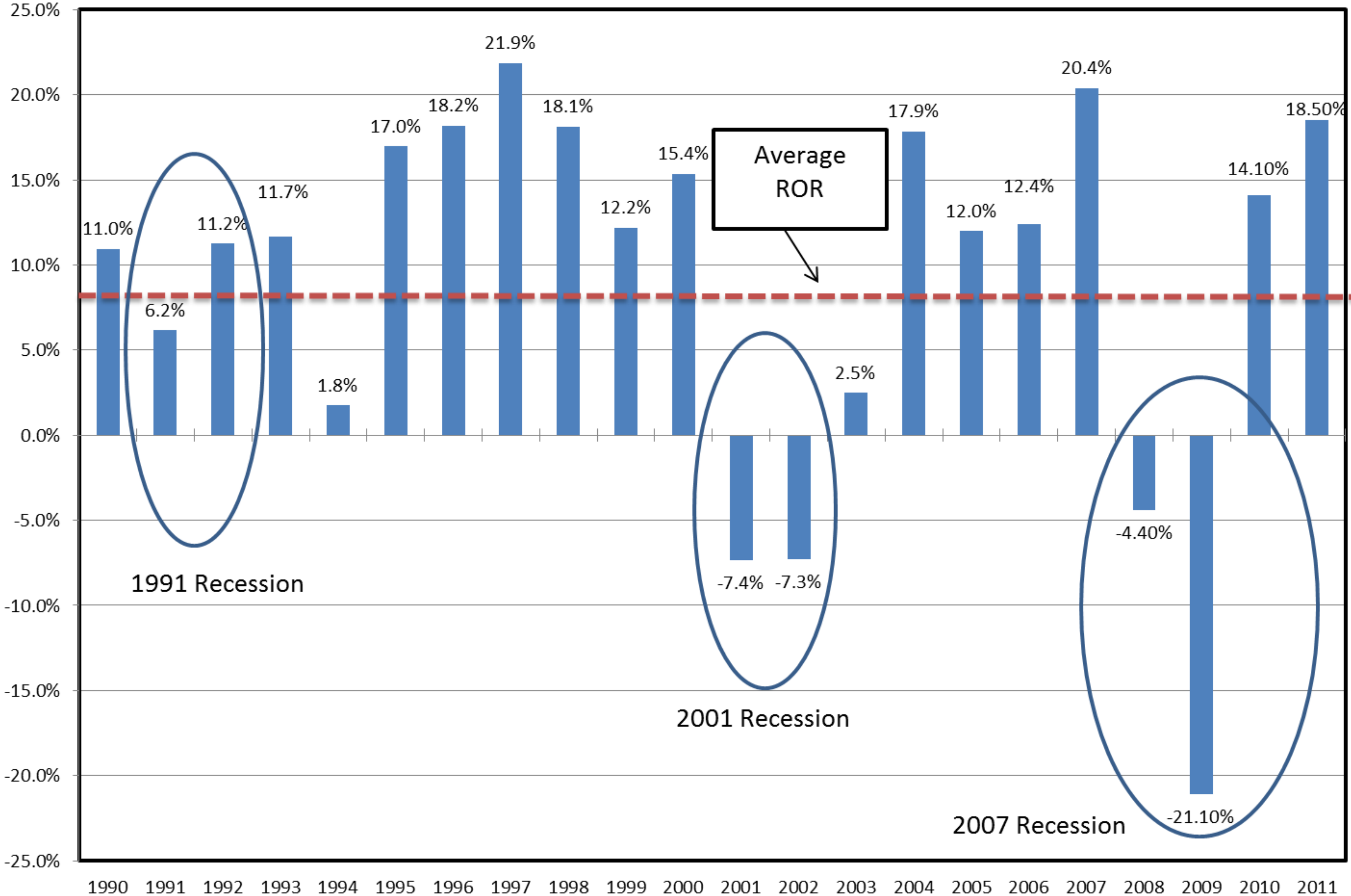
- By contrast, the General Assembly and the Governor have consistently used a 8.0% rate of return and a 30 year amortization period as a basis for setting VRS contribution rates
- As required by the Constitution, these assumptions are consistent with generally accepted actuarial principles
  - 8.0% ROR is consistent with assumptions made by the majority of public pension plans in the country
- The 8.0% assumed rate of return is less than the actual average rate of return realized since 1990
  - The rate of return assumption used in the rate setting process represents the assumed rate of return over the long term, a period in excess of 50 years, and is not intended to assume the next year's ROR

63% of Public Sector Retirement Plans Assume a ROR of 8.0% or Higher



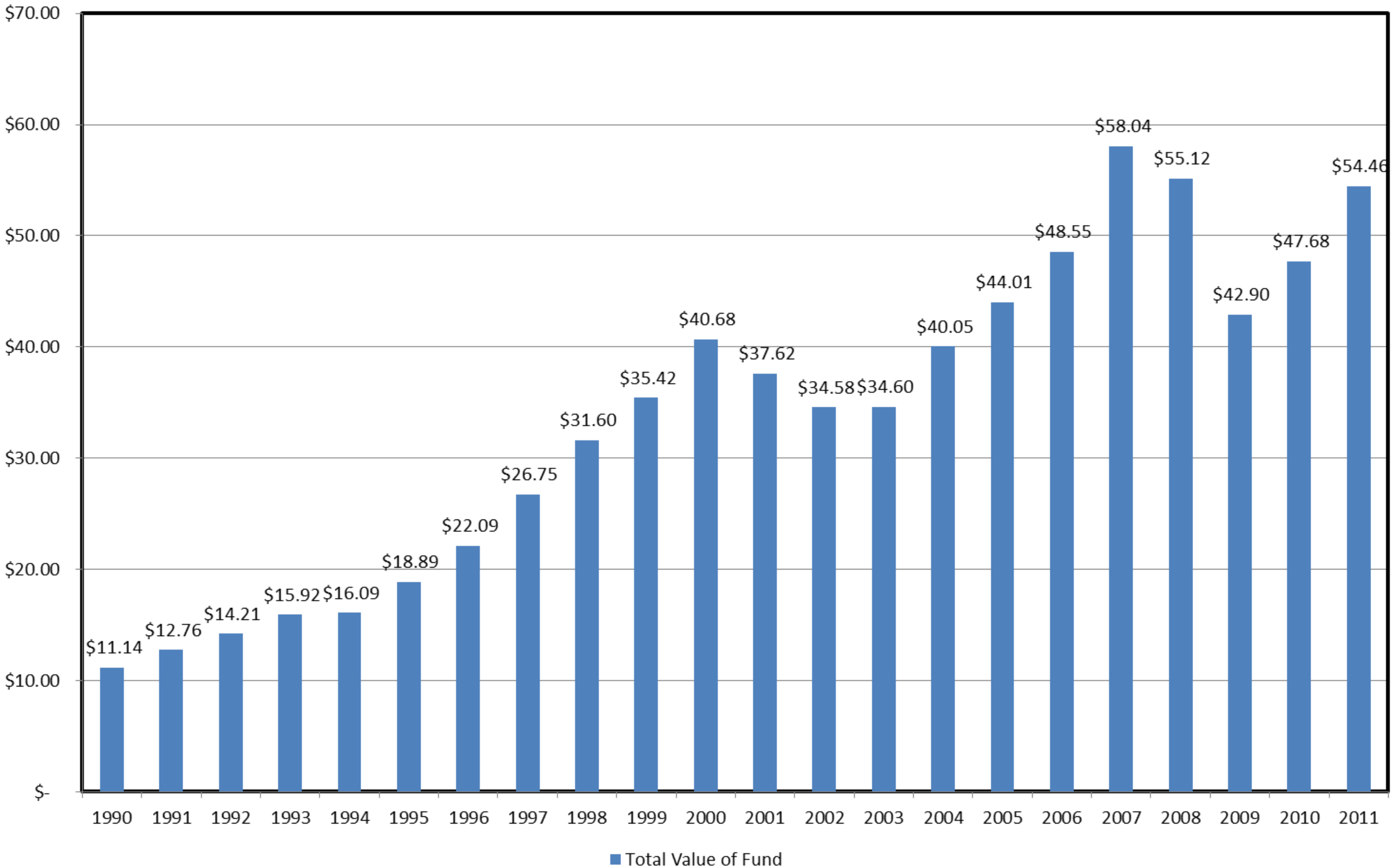
Data Source: National Association of State Retirement Administrators, includes assumptions from 126 plans from across the country

Since 1990 The Average ROR Has Been 8.63%



Fund Has Recovered $12 Billion Since Market Collapse

(in billions on June 30)



Comparison of 2012-2014 VRS Rates Based on Assumed ROR

Program	8.0% ROR, 2.5% COLA & 30 Yr Amrt.	7.0% ROR, 2.5 COLA & 30 Yr Amrt.
State Employee	8.80%	13.07%
SPORS	24.86%	32.62%
VaLORS	14.87%	19.52%
JRS	45.57%	54.11%
Teacher	11.71%	16.77%

* VRS Board proposed rates are based a 7.0% rate of return, 2.5% COLA, and 30 year amortization.

** All proposed rates reflect the 10 year repayment language related to the 2010-2012 deferral

Comparison of 2012-2014 OPEB Rates Based on Assumed ROR

Program	8.0% ROR, 30 Yr Amrt.	7.0% ROR, 30 Yr Amrt.
State HIC	1.00%	1.05%
Group Life	1.19%	1.32%
VSDP *	0.47%	0.58%
Teacher HIC	1.11%	1.17%

* VSDP rates assume 2.5% COLA

Overview

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- ✓ APA Review of State Employee Health Insurance Fund

Review of State Employee Health Insurance Plan

- Item 2.D. of the 2011 Appropriation Act requires the Auditor of Public Accounts to complete a financial review of the state employee health insurance fund (HIF)
  - Report was completed in October 2011
- The review was requested to address questions resulting from higher than projected balances in the HIF in recent years

Review of State Employee Health Insurance Plan

- At of the end of FY 2008 the cash balance in the HIF totaled $274.4 million
- Since FY 2009 the employee and employer rates have been decreased to reflect a rate “subsidy” from the excess HIF balances
- The balance in the HIF has decreased since 2009 but at a significantly lower rate than projected each year
- In FY 2012 the premium subsidy represents approximately 15% of the total premium for the “basic” health insurance plan
  - Reduces total employee and employer contributions into the fund by approximately $130 million ($60 million GF)

Year End Balances for the HIF ($ in millions)

June 30 Fiscal Year End	Active Employees/ Early Retirees	Medicare Retirees	Total
2007	$191.8	$29.8	$221.6
2008	$250.0	$24.4	$274.4
2009	$229.0	$39.2	$268.2
2010	$174.2	$43.5	$217.7
2011 *	$151.1	$46.6	$197.7
2012**	$111.0		

* 2011 balance includes $7.1 million in federal funds provided under federal healthcare reform which can only be used to offset future premium or other cost increases for early retirees

** June 2012 calculation is the APA projection of what the balance will be at the end of the current fiscal year.

APA Findings

- The APA review found that the state employee rates have been developed using accepted actuarial standards and were based on industry trends available at the time
  - An unexpected decrease in the claims expenses during the period of 2009 through 2011 resulted in the continued balances in the HIF
- The most significant recommendation from the APA report is that the General Assembly may wish to establish “HIF reserve funding policy” in either the Appropriation Act or the Code

Typical Components in a Revenue Reserve

- Incurred But Not Paid Claims (IBNP) – The estimated value of medical services that have already been provided but not yet paid
  - Estimated at $71.0 million for employee/early retiree pool for year-end 2011
- A Contingency Reserve, in addition to the IBNP, is commonly required of private insurance companies
  - The APA review noted that most states and self-insured companies focus only on funding their IBNP reserve
  - A few states have developed a contingency reserve policy (Tennessee requires a contingency reserve equal to 10% of the prior years medical expenditures)
  - The SCC requires regulated commercial insurance companies to hold a contingency reserve based on the National Association of Insurance Commissioners risk based capital formula

Line Of Credit Language in Appropriation Act

- In lieu of a contingency reserve, the Appropriation Act authorizes the State Comptroller to provide a $50.0 million line of credit for the Health Insurance Fund in case of emergency

Additional Costs for Employee Health Insurance in 2012- 14 Biennium

- Additional funding required assuming 7% annual inflation and $80.0 million reserve at end of biennium
    - Approximately $33.0 million GF in FY 2013 and $75.0 million GF in FY 2014