



SENATE FINANCE RETIREMENT SUBCOMMITTEE PRESENTATION

November 2, 2011

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What is OPEB?

OPEB (or Other Post-Employment Retirement Benefits) refers to retiree benefits “other” than the retirement benefit itself.

Although the State Health Plan (SHP) is fully funded for each plan year, including retiree benefits, the Governmental Accounting Standards Board (GASB) has issued Statements 43 and 45, which govern OPEB. OPEB requires the State to essentially pre-fund future retiree medical, prescription drug and dental insurance benefits that will be provided to all eligible State and School District retirees.

The State has an OPEB obligation with regard to state employees/retirees and school district employees/retirees who are eligible for retiree health coverage under Section 1-11-730.

Local subdivision and other employers participating in SHP have their own OPEB obligations.

Pursuant to GASB 45, government employers have to note on their accounting statements how much it would cost to fully fund current and future OPEB costs. This cost could be noted as “unfunded liabilities” for the future costs, but the cost could only be amortized over a 30-year time period. Thus, governmental entities were required/allowed by GASB 45 to make annual required contributions to an irrevocable trust of an amount equal to the present value of future OPEB expenses related to the employees’ services in the current fiscal year and an amount sufficient to amortize the unfunded actuarial accrued liability over a period up to 30 years.

Development of OPEB Valuation

Using data from the Employee Insurance Program and the Retirement Systems, the actuaries, GRS, developed Baseline Costs. An OPEB valuation is a projection of long-term benefit costs. The actuary first develops reasonable Baseline Costs for the current year and then projects these costs many years ahead.

The actuaries look at the current cost of benefits for retirees and their dependents and survivors separately by age, sex, benefit type (medical, prescription, drug and dental) and health status (disabled and non-disabled).

Baseline Costs vary depending on many different factors, but the most obvious variable that affects medical coverage is age.

The actuary analyzed the paid claims data for medical and pharmacy by age and sex.

Total claims before age 65 are considerably higher than the total claims after age 65. This decrease occurs because Medicare coverage begins at age 65. The State is the primary insurer for retirees under age 65, but provides secondary insurance once retirees are eligible for Medicare. Also, the total claims before age 65 are increasing considerably faster than the number of lives is increasing in that age group.

GRS then developed an aging factor table. Previous valuations had used the claims history of EIP for calendar years 2001-2005. Because revisiting experience every 4-5 years is appropriate, GRS developed a new aging table for the current valuation using the claims history of EIP for calendar years 2005-2009.

Two Types of Employer Contributions for Retirees

State Funded Subsidy

This is the amount of state-funded premiums provided to state and school district retirees under Section 1-11-730. The State pays the employer portion of the premium (72%) and the retiree pays the employee premium. This subsidy is funded by the payroll contribution under Section 1-11-710(A)(2).

Example 1: Assume a 62-year-old male State retiree:

State-Funded Premium	\$260.90
Employee/Retiree Premium	<u>+ 93.46</u>
Total Premium	\$354.36

The amount of the State-Funded Premium, \$260.90, is the State-Funded Subsidy.

Implicit Rate Subsidy

Retirees do not pay the true age-adjusted cost of their health coverage. The SHP insures both retirees and active employees in the same risk pool and the premiums are set based on the combined risk pool. The resulting premiums are lower than the true cost for retirees and higher than the true cost for active employees. Thus, the State is financing part of the total retiree cost through the amount of the premium.

The amount of the implicit rate subsidy is transferred annually from the Retiree Trust to the SHP claims fund.

Example 2: Assume a 62-year-old male State retiree:

Current Estimated True Monthly Cost of Coverage	\$584.90
Less Current Blended Monthly Premium Collected	<u>- 354.36</u>
Implicit Rate Subsidy	\$230.54

The amount of the implicit subsidy has been increasing substantially over the last three years.

OPEB Implicit Subsidy	
Fiscal Year	Amount of subsidy
2009	\$13.46 million
2010	\$15.85 million
2011	\$39 million

South Carolina's Response to OPEB

In 2008, the S.C. General Assembly passed Act 195 (effective 5/1/2008) establishing the South Carolina Retiree Health Insurance Trust Fund. This Trust provides funding for the employer premium cost for health benefits for retirees (§ 1-11-705). Contributions to the Retiree Trust, plus investment earnings on those monies, are intended over time to fund the State's OPEB accrued liability.

The Budget and Control Board is the trustee of the Fund and the State Treasurer is the custodian. EIP administers the fund.

The Retiree Trust is not invested in equities because the proposed constitutional amendment to allow equity investment was defeated by South Carolina voters.

The State Treasurer invests and reinvests the Retiree Trust Fund. The State Treasurer's office has estimated that a 6% per annum rate would be reasonable long-term return for a fixed income portfolio. Because the State funds some amount above the "pay as you go" amount but does not fund the entire annual required contribution for OPEB, the State is only allowed to use a 5.5% return for the valuation under GASB partial funding rules.

Funds are transferred out of the Retiree Trust on a monthly basis to pay for state-funded retiree health insurance premiums under Section 1-11-703(J).

As of June 30, 2010, the State's OPEB obligation is:

Total actuarial accrued liability	\$9.632 billion
Less Trust Assets	<u>- .487 billion</u>
Unfunded Actuarial Accrued Liability	\$9.145 billion

Sources of OPEB Funding

The primary sources of funding for the State's OPEB trust are:

- 1) state agencies and school districts pay a percentage of their payroll to the Retirement Systems to fund the cost of the current year's state-funded retiree premiums;
- 2) appropriations from the General Assembly;
- 3) each December 31st any amount in the SHP's operating account in excess of 140% of incurred but not reported (IBNR) expenses is transferred to the Trust Fund; and
- 4) investment income.

Payroll Contribution Funding Mechanism

Under S.C. Code Ann. Section 1-11-710(A)(2), the employer contribution rates of the South Carolina Retirement Systems are increased to a level to cover the employer's share for the current fiscal year's cost of providing health and dental coverage to retired state and school district employees.

The employer contribution paid for each Retirement Systems member covered by that employer has been increased by 4.3% beginning July 1, 2011.

The Retirement Systems collects the 4.3% of payroll contribution amount and transfers it into the Retiree Trust.

The Employee Insurance Program then transfers funds out of the Retiree Trust on a monthly basis to pay for state-funded retiree health insurance premiums under Section 1-11-703(J).

Employer Payroll Contribution History	
2002-2003	3.15%
2003-2004	3.30%
2004-2005	3.25%
2005-2006	3.25%
2006-2007	3.35%
2007-2008	3.42%
2008-2009	3.50%
2009-2010	3.50%
2010-2011	3.90%
2011-2012	4.30%

OPEB Historical Information

As of June 30, 2010, the unfunded OPEB liability is \$9.145 billion. The actuaries utilized a 5.5% discount rate and amortized the unfunded liability over a period of 30 years.

Unfunded OPEB Liability		
FY Ending	Unfunded Liability	Trust Assets
2008	\$9 billion	\$270.153 million
2009	\$ 9.203 billion	\$439.903 million
2010	\$ 9.145 billion	\$487.496 million
2011	not available	\$477.124 million

The value of assets in the Retiree Health Trust on June 30, 2011, was \$477.124 million.

The Annual Required Contribution for 2011 is \$815 million. The Annual Required Contribution is the amount needed to cover the current year's retiree health costs plus an amount to cover the portion of the unfunded liability to be amortized during 2011.

The Annual Required Contribution for the year ending June 30, 2012, is \$787 million.

History of Contributions to Retiree Trust Fund			
FY Ended	GASB ARC	Actual Contribution	Percentage Contributed
2008	\$692.714 million	\$569.352 million	82.19%
2009	\$727.079 million	\$369.844 million	50.87%
2010	\$785.250 million	\$296.502 million	37.76%
2011	\$815.825 million	\$302.755 million	37.11%
2012	\$787.293 million	not available	not available

Percent of Liability Funded			
FY Ending	Actuarial Accrued Liability	Trust Assets	Percent Funded
2008	\$ 9.280 billion	\$270.153 million	3%
2009	\$ 9.644 billion	\$439.903 million	5%
2010	\$ 9.632 billion	\$487.496 million	5%
2011	not available	\$477.124 million	not available

Trust Fund Investment Income	
FY Ending	Investment Income
2008	(\$ 229,913)
2009	\$32,638,533
2010	\$35,137,004
2011	\$17,059,325

2011 OPEB Trust Change in Plan Net Assets

In Fiscal Year 2011, the OPEB Trust decreased its assets by \$10.3 million to finish with net assets of \$477.123 million on June 30, 2011.

2011 Additions to Trust

In the fiscal year ending June 30, 2011, there were total additions to the Trust of \$319,847,045.

Retiree Surcharge	\$283,283,213
State Appropriations	+ 2,375,300
IBNR Transfer	+ 17,096,870
Investment Income	+ 17,059,325
Security Lending Earnings	+ 32,337
Total Additions	\$319,847,045

2011 Deductions

In the fiscal year ending June 30, 2011, there were total deductions to the Trust of \$330,219,364.

Transfer to EIP for Retiree Premiums	\$330,162,157
Administrative Expenses	+ 57,207
Total Deductions	\$330,219,364

Net Decrease in Assets

2011 Total Additions	\$319,847,045
Less 2011 Total Deductions	<u>-330,219,364</u>
Net Decrease in Assets	(\$ 10,372,319)

2011 Change in Assets

Net Assets as of June 30, 2010	\$487,495,881
Less Net Decrease in Assets (total additions – total deductions)	<u>(\$ 10,372,319)</u>
Net Assets as of June 30, 2011	\$477,123,562

The State Provides Health Insurance to Retirees of the State and School Districts

Under S.C. Code Ann. Section 1-11-730, the State provides state-paid employer premiums to eligible State and School District retirees.

A. Under Section 1-11-730, if an employee of a State agency or school district began employment before May 1, 2008:

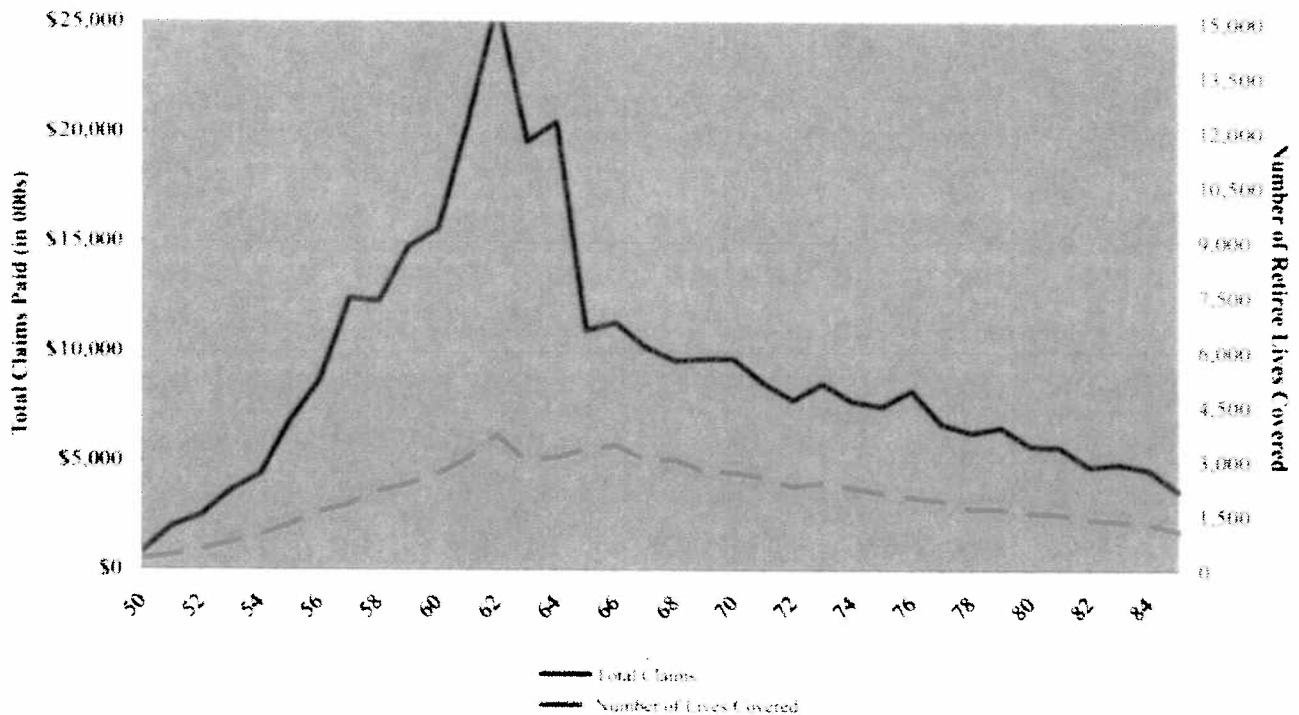
Service at Retirement	Premium
Terminate with 20 or more years	State pays 100% of employer premium/ Retiree pays 100% of retiree premium
Retire with 10 or more years	State pays 100% of employer premium/ Retiree pays 100% of retiree premium
Retire with 5 years but less than 10	Retiree pays 100% of employer premium/ Retiree pays 100% of retiree premium

B. An employee of a State agency or school district who began employment after May 1, 2008, and has either terminated with 20 years of service or retires with 5 or more years of service is eligible for state-paid premiums as follows:

Service at Retirement	Premium
Retire with more than 25 years	State pays 100% of employer premium/ Retiree pays 100% of retiree premium
Retire with 15-24 years	State pays 50% of employer premium/ Retiree pays 50% of employer premium/ and Retiree pays 100% of retiree premium
Retire with 5 years but less than 15	Retiree pays 100% of employer premium/ Retiree pays 100% of retiree premium

Total Claims Paid for Retirees in 2009

2009 Total Claims Paid Compared to Number of Retiree Lives Covered, by Age
(\$ in '000s)



Clearly, the total claims before age 65 are considerably higher than the total claims after age 65. This decrease occurs because Medicare coverage begins at age 65. Also, the total claims before age 65 are increasing considerably faster than the number of lives is increasing. For example, the average claim per member is higher for a member age 63 than a member age 57.

The following graph shows the average monthly claim costs per member.

Actual Monthly Claims Per Retired Member

