



VERMONT LEGISLATIVE Joint Fiscal Office

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Fiscal Note

May 20, 2022

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S.286 (Act 114) – An act relating to amending various public pension and other postemployment benefits

As Passed by the General Assembly

Link to Bill: <https://legislature.vermont.gov/Documents/2022/Docs/ACTS/ACT114/ACT114%20As%20Enacted.pdf>

Bill Summary

This [legislation](#) implements the final recommendations of the [Pension Benefits, Design, and Funding Task Force](#) created by the Legislature in [Act 75 \(2021\)](#). Based on preliminary actuarial estimates, **the bill is expected to reduce Vermont's long-term unfunded retirement liabilities for state employees and teachers by approximately \$2 billion** by prefunding other post-employment benefits, modifying the pension benefit structure, and making additional State and employee contributions into the retirement systems.

This bill contains a **\$200 million one-time General Fund appropriation in FY 2022** to the pension systems to pay down unfunded liabilities – \$75 million to the Vermont State Employees' Retirement System (VSERS) and \$125 million to the Vermont State Teachers' Retirement System (VSTRS). The bill also contains a **\$13.3 million one-time Education Fund appropriation in FY 2022** to the Retired Teachers' Health and Medical Benefits Fund to begin prefunding health care benefits for retired teachers.

The bill also creates a new VSERS pension benefit group (Group G) for certain State employees of the Department of Corrections and other agencies. This benefit is structured to be cost-neutral to the employer.

Overview of Legislation

Pension Provisions

S.286 includes the following pension-related provisions, which are proposed to take effect for the VSERS and VSTRS retirement systems beginning in FY 2023 (unless noted otherwise):

- **No changes to the benefits of current retirees, beneficiaries, or terminated vested members.**
- **State makes a one-time \$200 million payment toward unfunded pension liabilities.** The payment would be made in FY 2022 from reserved general funds and allocated \$75 million to VSERS and \$125 million to VSTRS. This payment is expected to immediately reduce the unfunded liabilities and improve the funded ratios. It is also expected to save interest costs and reduce the actuarially determined employer contributions (ADEC) in the future, with relative savings beginning in FY 2024 at approximately \$19.5 million in total across both systems.
- **Higher employee contribution rates for active members of both systems,** phased in over a 3- to 5- year period. By full phase-in, the higher contribution rates are expected to yield approximately \$14

million (VSERS in FY 2027) and \$10.3 million (VSTRS in FY 2025) of revenue, which would reduce the respective employer normal costs (which are paid through the ADEC) by a commensurate amount.

- **Modifications to the Cost-of-Living-Adjustment (COLA) formula for all employee groups, plus changes to other terms of the pension benefit for VSERS Groups C and D.** The changes are expected to yield approximately \$58 million of unfunded liability reduction and \$8.7 million of relative ADEC savings for VSERS, and \$35 million of unfunded liability reduction and \$4.8 million of relative ADEC savings for VSTRS.
- **Creation of a new VSERS pension group for certain Department of Corrections employees and other state employees who staff facilities for offenders, justice-involved youth, or patients in the care of the State.** Per the Task Force recommendations, the Group G proposal is designed to be cost-neutral to the employer, with the cost to fund the enhanced benefit paid by active members of the group.
- **State commits to ongoing additional payments toward the unfunded liability.** Beginning in FY 2024, an additional payment above the actuarially recommended amount would be included in the annual appropriation requests for the pension systems. The additional payment would increase to a maximum of \$15 million per system by FY 2026 and remain in place until the respective systems reach 90 percent funded. This provision effectively reinvests a portion of the expected future cost savings from the \$200 million one-time payment and pension modifications into further paying down the accrued unfunded pension liabilities.

Other Post-Employment Benefits (OPEB)

Sections 15, 24, and 25 contain language to prefund health care benefits (OPEB) for retired State employees and teachers. Currently, benefits for today's retirees are funded on a pay-as-you-go basis with minimal prefunding. By prefunding, the State will realize a reduction of its unfunded liabilities by approximately \$891.3 million for VSERS and \$836.8 million for VSTRS due to the ability to discount liabilities using the 7.0% rate of return adopted by the Vermont Pension Investment Commission (VPIC) for the pension investments rather than the lower 2.2% rate that must be used in the absence of prefunding per government accounting rules. Prefunding will result in long-term savings from the ability to take advantage of compound investment gains over time to fund future benefits, but it will require higher expenses in the near term. In FY 2023, \$15.1 million is needed from the Education Fund to begin funding the OPEB normal cost, and approximately \$15 million of General Fund is needed across both systems to transition to prefunding. Other provisions of the bill, however, such as the proposed increases to employee contribution rates, COLA modifications, and the impact of one-time State contributions, are expected to result in future recurring savings in pension costs that will offset a substantial portion of the added fiscal impact from prefunding OPEB. Additionally, Section 26 proposes to repeal the July 1, 2023 sunset for the annual charge for teacher health care paid by Local Education Agencies per [16 V.S.A. § 1944d](#). This language continues the practice of LEAs making annual contributions toward OPEB costs for teachers hired after July 1, 2015.

Year-End Surplus Construct

Beginning with the close of FY 2023, Section 29 amends the existing statutory construct in [32 V.S.A. § 308c\(a\)\(3\)](#) that dedicates 50 percent of unreserved and undesignated year-end General Fund surpluses to the Vermont State Employees' Postemployment Benefits Trust Fund (VSERS OPEB). The bill would instead direct any such surpluses equally to the VSERS and VSTRS pension systems, with the VSTRS share dedicated to a newly created account to support future changes to retirement benefits when the VSTRS system is in a stronger financial position. It is not possible to accurately estimate the fiscal impact of this provision since the amount of unreserved and undesignated surpluses are subject to other spending decisions and actual end-of-year revenue collections which vary from year to year.

Other Provisions

Sections 16, 17, 18, and 27 contain clarifying amendments to several provisions enacted in Act 75 (2021)

pertaining to the required frequency of experience studies and asset and liability studies for the three statewide pension systems. Act 75 stipulated that the Vermont Pension Investment Commission (VPIC) shall perform asset and liability studies on a three-year basis beginning on July 1, 2022. Act 75 further stipulated that the three Retirement Boards perform experience studies at least once every three years after the effective date of the Act—the prior requirement was at least once every five years. The language in these sections clarifies, where appropriate, that the three-year cycle is defined as three *fiscal years* of actuarial data, not the three-year anniversary of the completion date of the most recent studies. The language also provides the VPIC and Retirement Boards with the option to delay the upcoming studies by a year in order to include FY 2023 data in the studies. The most recent experience studies were based on the FY 2019 valuations. Without this change, the next experience studies would cover data for the three fiscal years from FY 2020 through FY 2022 and omit many impacts from the changes contained in this bill that take effect in FY 2023. The Vermont Municipal Employees’ Retirement System (VMERS) is outside the scope of the remainder of the bill, but this specific change also applies to that system for the administrative convenience of having all three pension systems complete experience studies and review actuarial assumptions on the same schedule.

Modifications to the State Employees’ Retirement System (VSERS)

Proposed Pension Benefit Changes

S.286 makes numerous modifications to the pension benefit structure for VSERS active members (*see Table 1*). No changes would impact current retirees, beneficiaries, or terminated vested members. Certain changes would not apply to active members who are at or approaching eligibility for normal or unreduced retirement as of the effective date of the changes (July 1, 2022).

Preliminary actuarial analysis commissioned for the Pension Task Force expects these changes will reduce the State’s actuarially determined employer contribution (ADEC) by approximately \$8.7 million and the VSERS unfunded liability by approximately \$58 million. These impacts come primarily from the changes to the COLA benefit, which are expected to lead to a change in the long-term actuarial assumptions used to calculate the normal cost and accrued liabilities. Reductions in the ADEC accrue to the funds of State government in proportion to those funds’ shares of the active payroll – approximately 40% typically falls to the General Fund, with the rest charged to federal and special funds.

Table 1: VSERS Current and Proposed Pension Provisions to Existing Groups

	Current	Proposed	Comments	Bill Sec.
Group C – Law Enforcement/Public Safety (439 active members – FY 2021)				
Unreduced early retirement	Age 50 with at least 20 years of service (whichever is later)	No change	Most Group C members retire under unreduced early retirement at age 50 with at least 20 years of service. No change is proposed.	
Mandatory normal retirement	Age 55 with at least 5 years of service, or completion of 30 years of service (whichever is earlier)	Age 57 with at least 5 years of service, or completion of 30 years of service (whichever is earlier)	The mandatory normal retirement age is proposed to increase from age 55 to 57. This recommendation will not change the current age 55 normal retirement eligibility or require any members to work until age 57 if they are otherwise eligible to retire sooner.	Sec. 5
Max Benefit Payable	50% of Average Final Compensation	50% of Average Final Compensation, plus 1.5% for each year of continuous service worked after 7/1/22 after reaching the later of Age 50 or 20 years of service	Proposed to incentivize members to voluntarily work beyond the age at which they are eligible to retire with an unreduced benefit (age 50 with at least 20 years of service). As of FY 2021, only 12 of the 439 active Group C members (2.7%) remained in service beyond the age at which they are eligible for unreduced early retirement. Encouraging additional members to retire at later ages than they otherwise would is expected to result in actuarial savings.	Secs. 5-6

Group C – Law Enforcement/Public Safety (439 active members – FY 2021) - Continued				
COLA	Member must receive a retirement benefit for at least 12 months before receiving a COLA.	Member must receive a retirement benefit for at least 24 months before receiving a COLA.	Proposed change would only apply to active members who become eligible for normal or unreduced early retirement on or after 7/1/22.	Sec. 10
COLA	Net percentage change in the CPI used to calculate the COLA has a 1% minimum, 5% maximum.	Net percentage change in the CPI used to calculate the COLA has a 4% maximum.	Proposed change would only apply to active members who become eligible for normal or unreduced early retirement on or after 7/1/22.	Sec. 10
Group D – Judicial (51 active members – FY 2021)				
Average Final Compensation	Final salary at retirement	Average of 2 highest consecutive years	Proposed change would not apply to active members who are age 57+ with at least 5 years of service, or to members with 15+ years of service at any age, as of 6/30/2022.	Sec. 2
Unreduced normal retirement	Age 62 with at least 5 years of service	For members first appointed on or after 7/1/2022, age 65 with at least 5 years of service	Proposed change would increase normal retirement age from 62 to 65 for new hires. Group D members are typically hired at, and work to, later ages than other groups. As of FY 2021 only 22 of the 51 active Group D members (43.1%) were younger than age 60, and 29 of the 51 active Group D members (56.9%) were at least age 60.	Sec. 2
Max Benefit Payable	100% of Final Salary	80% of Average Final Compensation (2 highest consecutive years)	Proposed change would not apply to active members who are age 57+ with at least 5 years of service, or to members with 15+ years of service at any age, as of 6/30/2022.	Sec. 5
COLA	Member must receive a retirement benefit for at least 12 months before receiving a COLA	Member must receive a retirement benefit for at least 24 months before receiving a COLA	Proposed change would only apply to active members who are appointed or elected on or after 7/1/22.	Sec. 10
COLA	Full COLA (100% of net CPI change) on full amount of retirement benefit paid.	Full COLA (100% of net CPI change) on first \$75,000 of retirement benefit paid. Reduced COLA (50% of net CPI change) on benefit paid above \$75,000.	Proposed change would only apply to active members hired on or after 7/1/22.	Sec. 10
Group F – General Public Employees (7,701 active members – FY 2021)				
COLA	Member must receive a retirement benefit for at least 12 months before receiving a COLA	Member must receive a retirement benefit for at least 24 months before receiving a COLA	Proposed change would only apply to active members who are eligible for normal or unreduced early retirement on or after 7/1/22.	Sec. 10
COLA	Net percentage change in the CPI used to calculate the COLA has a 1% minimum, 5% maximum	Net percentage change in the CPI used to calculate the COLA has a 4% maximum	Proposed change would only apply to active members who become eligible for normal or unreduced early retirement on or after 7/1/22.	Sec. 10

Proposed Employee Contribution Rates

Section 11 contains numerous modifications to the member contribution rates paid by active employees, beginning in FY 2023 (*see Table 2 on the following page*). Employee contributions are made on a pre-tax basis and revenue is credited toward the normal cost of the member's future pension benefits (not toward the unfunded liability). Additional revenue raised through employee contributions reduces employer pension expenses (the ADEC) by paying a greater share of the total normal cost that would otherwise fall to the employer to pay.

	Current	Proposed					Comments
	FY 22	FY 23	FY 24	FY 25	FY 26	FY 27	
Group C	8.53%	9.03%	9.53%	10.03%	10.03%	10.03%	Beginning in FY 2023, 0.5%/year increase for 3 years for all active members.
Group D	6.65%	<25 th percentile: 6.65%	6.65%	6.65%	6.65%	6.65%	Beginning in FY 2023, for all active members. The proposed rates mirror those proposed for Group F. 5-year phase-in of 0.5%/year contribution increases, by salary quartile. A member's effective contribution rate would be based on the quartile their base hourly rate of pay falls within, with the rate charged to every dollar earned by the member each fiscal year. Quartiles calculated annually from Group D active membership.
		25 th -50 th percentile: 7.15%	7.65%	8.15%	8.15%	8.15%	
		50 th -75 th percentile: 7.15%	7.65%	8.15%	8.65%	8.65%	
		75 th + percentile: 7.15%	7.65%	8.15%	8.65%	9.15%	
Group F	6.65%	<25 th percentile: 6.65%	6.65%	6.65%	6.65%	6.65%	Beginning in FY 2023, for all active members. The proposed rates mirror those proposed for Group D. 5-year phase-in of 0.5%/year contribution increases, by salary quartile. A member's contribution rate would be based on the quartile their base hourly rate of pay falls within, with the rate charged to every dollar earned by the member each fiscal year. Quartiles calculated annually from the combined Group F and G active membership.
		25 th -50 th percentile: 7.15%	7.65%	8.15%	8.15%	8.15%	
		50 th -75 th percentile: 7.15%	7.65%	8.15%	8.65%	8.65%	
		75 th + percentile: 7.15%	7.65%	8.15%	8.65%	9.15%	

Note: Table 2 reflects the total effective contribution rates to be paid by members, including the 0.1% contribution authorized by 3 V.S.A. § 473(f). The contribution rates reflected in the text of Section 11 of S.286, as passed by the House, omit the additional 0.1% contribution authorized by 3 V.S.A. § 473(f).

Preliminary actuarial analysis commissioned for the Pension Task Force expects these changes will generate approximately \$2.8 million of revenue in FY 2023, growing to approximately \$14 million by FY 2027 when the rates are fully phased in across all groups (see Table 3). Actual amounts may fluctuate from estimates, however, due to timing factors and fluctuations in the census and payroll characteristics of the active workforce.

After full phase-in of the new rate structure (expected to occur in FY 2025 for Group C, and FY 2027 for Groups D and F), overall payroll growth is expected to increase at a long-term annual growth rate of 3.5%. Revenue from employee contributions, in turn, would expect to increase at a similar pace with the size of the overall payroll when all else is equal.

Fiscal Year	Group C	Group F
FY 2023	0.2	2.5
FY 2024	0.4	5.3
FY 2025	0.6	8.4
FY 2026	0.6	11.1
FY 2027	0.6	13.3

Note: Group D is not reflected in these estimates but due to the small size of the group the additional expected revenue will likely be within a rounding error of \$0.1 million annually.

Group G

The legislation creates a new VSERS pension benefit (Group G) for certain employees of the Department of Corrections and other state entities (primarily within the Agency of Human Services) that provide direct supervision or treatment services. The Task Force recommended further study of the creation of a new pension benefit for this cohort of employees to allow for unreduced retirement at age 55 with at least 20 years of service with a higher benefit multiplier than Group F presently provides. The FY 2022 Budget Adjustment Act (Section 47 of [Act 83 \(2022\)](#)) subsequently directed the State Treasurer and VSERS Board of Trustees to make recommendations to the Legislature by April 15, 2022 on the creation of a new pension benefit group for Department of Corrections employees that is actuarially neutral to the pension system and results in no additional employer pension costs. The language contained in the legislation enacts the benefit recommended to the Legislature pursuant to this provision.

Under current law ([3 V.S.A. § 459\(d\)\(2\)\(A\)](#)), Group F members may retire early with an unreduced benefit at age 55 with at least 20 years of service if they performed that service *“as facility employees of the Department of Corrections, as Department of Corrections employees who provide direct security and treatment services to offenders under supervision in the community, or as Woodside facility employees, or as Vermont State Hospital employees, or as employees of its successor in interest, who provide direct patient care...”* This universe consisted of 796 employees as of October 2021, with 674 employed by the Department of Corrections and 122 employed by other agencies. Under Group F’s benefit multiplier of 1.67 percent, a member covered by this provision would receive a benefit of approximately 33.33 percent of their average final compensation after 20 years of service.

Under Group G, a similar universe of members who are covered by the existing Group F statutory provision allowing for unreduced early retirement at age 55 with at least 20 years of service would be entitled to a benefit calculated with a higher multiplier of 2.5 percent. Under this formula, a member with 20 years of service would receive a normal retirement benefit of approximately 50 percent of their average final compensation – which would be the maximum benefit payable for new hires (*see Table 4*). This benefit accrual formula is similar to the one currently in place for the smaller VSERS Group C (law enforcement and public safety).

For new hires, normal retirement under Group G will be age 55 with 20 years of service, and members would be eligible for an early retirement benefit at age 55 with at least 5 years of service with an actuarially equivalent reduction.

Most other Group G benefit provisions are substantially similar to those currently in place or proposed for Group F.

Members hired into positions within this universe on or after July 1, 2023 would be enrolled in Group G, rather than the existing Group F. Existing Group F members in this universe, and members hired on or before March 31, 2023, would have a one-time option to transition to the new Group G by June 1, 2023. Members hired on or after April 1, 2023 would have 60 days from the date of hire to elect to join Group G. Members who transition from Group F to Group G would retain other terms of their current Group F benefit structure without modification, but future service credit earned after enrolling in Group G would accrue under the higher 2.5 percent benefit multiplier. The higher multiplier would not apply retroactively to service performed prior to enrolling in Group G.

	Group F (Current)	Group G (Proposed)
Benefit Multiplier	1.67% per year of credited service after 1/1/91	2.5% per year of credited service in Group G.
Maximum Benefit Payable	50% of Average Final Compensation if hired prior to 7/1/08 60% of Average Final Compensation if hired on or after 7/1/08	50% of Average Final Compensation (new hires) Existing Group F provisions for transferring members
Approximate Benefit with 20 years of service	33.33% of Average Final Compensation	50% of Average Final Compensation
Normal Retirement Eligibility	Age 62 or with 30 years of service if hired before 7/1/08. Age 65 or Rule of 87 if hired on or after 7/1/08.	Age 55 with 20 years of service

As members accrue service under the higher benefit multiplier of Group G, the accrued liabilities of the VSERS pension system will increase above status quo expectations. **Actuarial analysis performed at the direction of the State Treasurer estimates that the present value of benefits owed by the VSERS pension system will increase by approximately \$41.4 million, which will require an additional contribution rate of 4.68 percent of Group G member salaries to fund.** For members, rather than the State, to fund this benefit without decreasing the broader actuarial benefits to the VSERS system from other elements of the legislation, Section 11 establishes Group G contribution rates at levels 4.68 percent higher than the levels proposed for Group F members for the applicable fiscal years (*as outlined previously in Table 2*). Aside from the 4.68 percent surcharge, Group G member contributions would otherwise be calculated under the new framework for Group F, based on salary quartiles calculated from the distribution of the hourly pay of the combined Group F and G active employees (*see Table 5*). The estimated cost of the Group G benefit, and the required member contribution necessary to fund it, are based on underlying actuarial assumptions about employee retirement and net turnover behavior, payroll growth, membership characteristics, demographic projections, and economic trends.

	FY 2024	FY 2025	FY 2026	FY 2027	Comments
<u><25th percentile:</u>	11.33%	11.33%	11.33%	11.33%	Beginning in FY 2024, for all active members. The proposed rates mirror those proposed for Group F, plus an additional 4.68% to fund the present value of the increased benefit. 4-year phase-in of contribution increases, by salary quartile. A member's contribution rate would be based on the quartile their base hourly rate of pay falls within, with the rate charged to every dollar earned by the member each fiscal year. Quartiles calculated annually from the combined Group F and G active membership.
<u>25th-50th percentile:</u>	12.33%	12.83%	12.83%	12.83%	
<u>50th-75th percentile:</u>	12.33%	12.83%	13.33%	13.33%	
<u>75th+ percentile:</u>	12.33%	12.83%	13.33%	13.83%	

Note: Table 5 reflects the total effective contribution rates to be paid by members, including the 0.1% contribution authorized by 3 V.S.A. § 473(f). The contribution rates reflected in the text of Section 11 of S.286, as passed by the House, omit the additional 0.1% contribution authorized by 3 V.S.A. § 473(f).

As with any actuarial estimate, these expected and actual costs may change in the future based on plan experience factors and potential future changes to assumptions. Future actuarial gains or losses may, in combination with other factors, impact the unfunded liability and amount of required employee contribution to maintain cost neutrality to the employer over time.

It is not presently known exactly what long-term impact Group G may have on the State’s OPEB obligations. As it is more expensive to insure a retired member who is not yet eligible for Medicare, it is possible that OPEB liabilities could increase in the future if the benefit structure of Group G encourages substantially more members to retire at earlier ages than they otherwise would under Group F. However, preliminary review by the State Treasurer based on the current membership characteristics of the VSERS membership does not expect that Group G will have a substantial impact on the State’s net OPEB liability in the near term.

**Modifications to the State Teachers’ Retirement System (VSTRS)
Proposed Pension Benefit Changes**

Section 23 makes several modifications to the pension benefit structure for VSTRS active members (*see Table 6*). Similar to the recommendations made for VSERS, no changes would impact current retirees, beneficiaries, or terminated vested members. The changes to the COLA would not apply to active members who are eligible for normal or unreduced retirement as of June 30, 2022.

Preliminary actuarial analysis commissioned for the Pension Task Force expects these changes will reduce the State’s actuarially determined employer contribution (ADEC) by approximately \$4.8 million and the VSTRS unfunded liability by approximately \$34.9 million. These impacts come from the changes to the COLA benefit, which are expected to lead to a change in the long-term actuarial assumptions used to calculate the normal cost and accrued liabilities. Reductions in the VSTRS ADEC accrue primarily to two funds of State government – savings from reducing the normal cost (approximately \$1.6 million) primarily accrue to the Education Fund, and savings from reducing the unfunded liabilities (approximately \$3.2 million) primarily accrue to the General Fund. A small portion of savings will also accrue to Local Education Agencies that make contributions to both the normal cost and unfunded liability on their federally funded staff.

Table 6: VSTRS Current and Proposed Pension Provisions				
	Current	Proposed	Comments	Bill Sec.
Group C – All Active Members Hired After 7/1/90 Plus Former Group B Members as of 7/1/90				
COLA	Member must receive a retirement benefit for at least 12 months before receiving a COLA	Member must receive a retirement benefit for at least 24 months before receiving a COLA	Proposed change would only apply to members who are active on or after 7/1/22.	Sec. 23
COLA	Net percentage change in the CPI used to calculate the COLA has a 1% minimum, 5% maximum	Net percentage change in the CPI used to calculate the COLA has a 0% minimum, 4% maximum.	Proposed change would only apply to members who are active on or after 7/1/22.	Sec. 23

Additionally, Sections 21 and 22 include language reflecting the General Assembly’s intent to consider future legislation that would create a path for the COLA benefit formula (or other terms of the benefit structure) to be increased in the future when the VSTRS pension system is at least 80 percent funded for members who leave active service on or after June 30, 2023. Currently, VSTRS Group C members receive a COLA in retirement that is calculated at 50 percent of the net percentage change in the CPI. The legislative intent, per the Task Force recommendations, is to eventually increase the COLA formula for members who paid approximately one year of the increased employee contributions (see below) once the system reaches 80 percent funded, provided that doing so would not result in the fund falling below 80 percent funded. As of the FY 2021 actuarial valuation, which does not reflect any of the changes in this bill, the VSTRS system is expected to reach 80 percent funded in approximately FY 2033.

Preliminary actuarial estimates reported to the Joint Fiscal Office by the Office of the State Treasurer indicate that if the necessary statutory changes to implement this recommendation were enacted now, they would increase the unfunded liability by approximately \$105 million and the ADEC by approximately \$16 million. Rather than enshrining this future benefit change into statute now, which would immediately increase the unfunded liability and ADEC, Section 21 creates a dedicated account that would receive the VSTRS portion of future General Fund surpluses, invest those funds, and use those assets to fund future increases to the benefit when the system is at least 80 percent funded, or in conjunction with other proposed changes to the amortization schedule. Section 22 establishes a process for evaluating the fiscal impacts of future benefit changes and making recommendations for legislative action to modify benefits in the future, provided that enough assets are in the newly created account to pay for the present value of those future benefit modifications and the Legislature enacts those benefit modifications into statute.

Proposed Employee Contribution Rates

Section 19 modifies the member contribution rates paid by active VSTRS employees, beginning on July 1, 2022. Employee contributions are made on a pre-tax basis and revenue is credited toward the normal cost of the member’s future pension benefits, not toward the unfunded liability. Additional revenue raised through employee contributions reduces employer pension expenses (the ADEC) by paying a greater share of the total normal cost that would otherwise fall to the employer to pay. Most of the savings from higher employee contributions would accrue to the Education Fund.

The Pension Task Force recommended moving to a progressive contribution structure for VSTRS members, beginning in FY 2023 (see Table 7). As originally recommended, a marginal rate structure with five fixed income brackets would be phased in over a three-year period. The member’s effective contribution rate would be determined annually by the bracket that their base annual contract salary falls within, with that effective rate charged on every dollar earned by the member over the course of the year. For example, a member with a \$45,000 base salary would pay an effective rate of approximately 6.06% on every dollar earned that year. The effective rate would be derived from calculating 6.00% on their first \$40,000 of base salary plus 6.50% on their next \$5,000 of base salary.

Preliminary estimates by JFO based on active payroll data suggest that approximately \$10.3 million of additional revenue could be generated by full phase-in of the rate structure in FY 2025, which will reduce the Education Fund’s contribution. Overall payroll growth is expected to increase at a long-term annual growth rate of 3.0%. Revenue from employee contributions, in turn, would expect to increase at a similar pace when all else is equal. However, actual revenues may fluctuate from estimates due to fluctuations in timing and the census and payroll characteristics of the active workforce.

Table 7: VSTRS Proposed Marginal Employee Pension Contribution Rates – As Originally Recommended

Current	Originally Proposed Marginal Rates			
	Income Bracket	FY 2023	FY 2024	FY 2025
Members At Least Age 57 or With At Least 25 Years of Service On 6/30/2010 pay 5.0%	< \$40,000	6.00%	6.25%	6.25%
	\$40,000.01—\$60,000	6.50%	6.75%	6.75%
	\$60,000.01 – \$80,000	6.75%	7.00%	7.50%
Members Less Than Age 57 or With Less Than 25 Years of Service on 6/30/2010 pay 6.0%.	\$80,000.01—\$100,000	7.00%	7.50%	8.25%
	\$100,000.01+	7.25%	8.00%	9.00%
Add'l Est. Revenue (\$ million)		6.2	8.7	10.3

Table 8: VSTRS Proposed Flat Employee Pension Contribution Rates for FY 2023-2024 – As Recommended in Amendment

Current	Proposed Flat Rates		
	Base Salary Level	FY 2023	FY 2024
Members At Least Age 57 or With At Least 25 Years of Service On 6/30/2010 pay 5.0%	< \$40,000	6.00%	6.10%
	\$40,000.01—\$50,000	6.05%	6.15%
	\$50,000.01 – \$60,000	6.10%	6.25%
	\$60,000.01—\$70,000	6.20%	6.35%
Members Less Than Age 57 or With Less Than 25 Years of Service on 6/30/2010 pay 6.0%.	\$70,000.01 -- \$80,000	6.25%	6.50%
	\$80,000.01-\$90,000	6.35%	6.75%
	\$90,000.01 - \$100,000	6.50%	7.00%
	\$100,000.01 +	6.65%	7.25%
Add'l Est. Revenue (\$ million)		6.2	9.1

Subsequent to the introduction of S.286, concerns were raised over the ability of employers to implement the originally recommended marginal withholding structure by the beginning of FY 2023 within the constraints of existing payroll systems. As an interim measure, the as-passed legislation includes an alternative contribution rate structure for FY 2023 and FY 2024. Similar to the VSERS proposal, this alternative structure charges flat rates (not marginal rates) on every dollar earned by an active member based on which of eight brackets their contract salary falls within (see Table 8). For example, a member with a base salary above \$40,000 and up to \$50,000 would pay 6.05% on every dollar earned in FY 2023. Estimates by JFO based on active payroll data suggest that this alternative rate structure will yield virtually the same amount of revenue in FY 2023 as the originally recommended marginal structure in Table 7. Section 20 directs the Agency of Digital Services and State Treasurer to consult with stakeholders to study and make recommendations to the Legislature on the implementation of the originally recommended marginal rate structure by January 15, 2023.

Additional State Pension Contributions
One-Time Pension System Contributions

Section 28 contains \$200 million of one-time General Fund contributions to the two pension systems to pay

down the respective unfunded liabilities — \$75 million to VSERS and \$125 million to VSTRS — in recognition of the fact that the VSTRS system has a significantly larger unfunded liability. Act 74 (2021) reserved \$150 million of FY 2021 general funds for pension funding initiatives, which Section 28 unreserves and appropriates equally to both systems. Section 28 also appropriates an additional \$50 million from FY 2022 general funds to the VSTRS system.

These one-time pension contributions would be made in FY 2022 and result in future recurring employer ADEC savings beginning two years in the future (FY 2024). Although the actual fiscal impact of these contributions will be determined by future actuarial valuations in conjunction with other experience factors, preliminary analysis commissioned by the Task Force estimates a Year 1 (FY 2024) impact of approximately \$7.3 million (VSERS) and \$12.2 million (VSTRS) of relative ADEC savings from one-time contributions of similar magnitudes. For VSERS, these savings would accrue to the funds of State government in proportion to their shares of the active payroll. For VSTRS, these savings would primarily accrue to the General Fund with a small portion accruing to Local Education Agencies on their federally funded staff.

Recurring Additional State Contributions to the Pension Systems

Sections 11 and 19 contain language expressing ongoing commitments of State funds to further accelerate the pay-down of the unfunded pension liabilities. Beginning in FY 2024, the first year of anticipated ADEC savings from the impact of the one-time contributions, the State would make supplemental contributions above the actuarially recommended amount and effectively redirect the savings into further paying down the unfunded liabilities. These sections propose additional amounts to each system of \$9 million in FY 2024, \$12 million in FY 2025, and \$15 million in FY 2026. The amounts would then remain at \$15 million until the respective pension system reaches 90 percent funded. According to the FY 2021 actuarial valuations, which do not reflect any of the impacts of the proposed changes contained in this bill, the systems are expected to reach 90 percent funded in a status quo situation in FY 2034 (VSERS) and FY 2036 (VSTRS), respectively.

Section 11 requires that the annual VSERS funding recommendation made by the Retirement Board shall reflect the actuarially determined employer contribution plus these additional payments toward the unfunded liability, with the total cost reflected in the annual percentage assessed to payroll across all the various employing agencies/departments and funds of state government. Section 19 includes a similar requirement of the VSTRS Retirement Board to reflect the additional payment in its annual funding request; however, VSTRS employer pension costs are paid through a direct appropriation in the annual appropriations bill. These commitments would be subject to appropriations by future legislatures.

Like one-time contributions, recurring contributions in excess of the actuarially recommended amount are expected to have positive impacts; improving the systems' funded ratios, accelerating the pay down of the unfunded liability, and resulting in future ADEC savings. While the Pension Task Force commissioned actuarial analysis on similar recurring revenue scenarios, the impacts of this specific provision have not been costed out by the actuaries to date.

Prefunding Other Post-Employment Benefits (OPEB)

Prefunding retirement benefits like pensions and OPEB involves setting aside funds over the course of an active member's career, investing those assets, and using the compound investment gains to partially fund the cost of future benefits. The initial costs of moving to prefunding are higher than the current "paygo" system of paying the benefits for current retirees as they become due. However, prefunding itself substantially lowers the State's unfunded retirement liabilities and is more cost efficient over time since investment gains offset expenses to taxpayers in the future.

Prefunding requires the State to enact a statutory funding policy that meets actuarial review, then commit to

future contributions above the “paygo” amount to build up a pool of surplus assets to be invested over time. At the end of the amortization period, the systems would be projected to have enough assets to fund the cost of benefits to future retirees, provided that the normal cost continues to be fully funded and all actuarial assumptions are met. With a statutory prefunding policy enacted, the assets of the two OPEB systems can be invested with VPIC with an assumed long-term rate of return that is currently 7.0 percent. By using a 7.0 percent rate of return to discount liabilities, rather than the 2.20 — 2.41 percent rates tied to the 20-year AA municipal bond rate that accounting rules require “paygo” systems to use, the unfunded OPEB liabilities would be reduced by approximately \$1.728 billion by the end of FY 2023 (see Table 9).

Table 9: Estimated Impact of Prefunding OPEB

	State Employee OPEB			Teacher OPEB		
	FY 2023 – Status Quo Paygo	FY 2023 – Prefunding	Change	FY 2023 – Status Quo Paygo	FY 2023 – Prefunding	Change
1. Rate of Return	2.41%	7.00%		2.20%	7.00%	
2. Actuarial Accrued Liability	\$1,787,402,771	\$901,630,521	(\$885,772,250)	\$1,519,502,091	\$683,414,665	(\$836,087,426)
3. Fund Assets	\$123,166,267	\$128,686,560	\$5,520,293	\$14,955,429	\$15,657,836	\$702,407
4. Unfunded Liability (2-3)	\$1,664,236,267	\$772,943,961	(\$891,292,306)	\$1,504,546,662	\$667,756,829	(\$836,789,833)
5. Normal Cost	\$66,216,417	\$20,897,140	(\$45,319,277)	\$56,584,557	\$15,104,597	(\$41,479,960)
6. Amortization of Unfunded Liability	\$55,898,305	\$43,680,845	(\$12,217,460)	\$52,403,565	\$39,709,031	(\$12,694,534)
7. Total ADEC (5+6)	\$122,114,722*	\$64,577,985	(\$57,536,737)	\$108,988,122*	\$54,813,628	(\$54,174,494)

(*) Under Status Quo Paygo, the OPEB ADEC is not fully funded. Instead, only the paygo cost of providing benefits to current retirees is appropriated. The proposed prefunding policy will require the ADEC (both the normal cost and the unfunded liability amortization payment) to be fully funded in future years. Source: FY 2021 GASB 74 Valuations.

Sections 15 and 24 contain the statutory funding policies required to prefund the OPEB benefits and fully fund the net unfunded liabilities by FY 2048. Like pensions, the OPEB prefunding would reflect an employer normal cost contribution to fund the future benefits of today’s active members, plus an amortization payment toward the unfunded liabilities already earned by the active and retired workforce. These annual payments are made into a benefits fund, which pays the cost of benefits for current retirees from the proceeds of those contributions and the compound investment gains earned on those assets over time.

Like how pensions are funded, Section 15 requires that the VSERS OPEB contribution amount be recommended annually by the Retirement Board and paid from an assessment charged to the funds of State government in proportion to their share of the active payroll. Typically, approximately 40 percent of these costs are paid from the General Fund, with federal and special funds paying the remainder. Likewise, Sections 24 and 25 mirror the VSTRS pension funding structure by paying the OPEB normal cost from the Education Fund and the unfunded liability amortization payment (net of contributions from LEAs) from the General Fund. Furthermore, Section 28 unreserves \$14 million of FY 2021 Education Fund that were reserved in Act 74 (2021) and appropriates \$13.3 million of those funds to the Retired Teachers’ Health and Medical Benefits Fund (teacher OPEB). This one-time appropriation will help seed the initial stages of prefunding these benefits while hedging against short-term volatility in investment performance, premium costs, plan experience, and other uncertainties. The VSERS OPEB fund, which received \$52.4 million from unreserved, undesignated General Fund surplus in FY 2021 per 32 V.S.A. § 308c(a)(3), has sufficient funding to begin prefunding without the need for additional initial appropriations for this purpose. Beginning in FY 2023:

- Prefunding VSERS OPEB is expected to have an increased cost of approximately \$22.2 million to all the funds of State government in proportion to their shares of the active payroll. Moving to prefunding would reduce the VSERS OPEB unfunded liabilities by approximately \$891.3 million.

- **Prefunding VSTRS OPEB** is expected to have an increased cost of approximately \$15.1 million to the Education Fund and \$5.5 million to the General Fund. Moving to prefunding would reduce the VSTRS OPEB unfunded liabilities by approximately \$836.8 million.

Additionally, Section 26 repeals the July 1, 2023 sunset for the annual charge for teacher health care paid by Local Education Agencies per [16 V.S.A. § 1944d](#). This language would continue the practice of LEAs making annual contributions for teachers hired after July 1, 2015. In FY 2023, these charges are expected to generate approximately \$6.1 million, which offsets the cost to the State of providing OPEB benefits.

Summary Chart – Preliminary Estimates of Fiscal Impacts by Fund

Table 10 summarizes the preliminary expected relative fiscal impacts of the various provisions contained in S.286, and Table 11 (on the following page) summarizes the additional state investments and impacts to the unfunded retirement liabilities by system.

Table 10: Preliminary Estimates of Anticipated FY23 Budget Impact of S. 286 (\$ millions)					
State Employees		FY23	Teachers		FY23
Current FY23 Budget For Employer Contribution			Current FY23 Budget For Employer Contribution		
Pension - Normal and Unfunded Liability		124.2 all funds	Pension - Normal		40.7 Ed Fund
OPEB/Retiree Health Care- PayGo		43.7 all funds	Pension - Unfunded Liability		157.5 GF
Total (payroll assessment funded)		167.9 all funds	OPEB/Retiree Health Care- PayGo		29.6 GF
			Total (payroll assessment funded)		227.8 all funds
S.286 Estimate Budget Need			S.286 Estimate Budget Need		
Pension - Normal and Unfunded Liability		112.7 all funds	Pension - Normal		32.9 Ed Fund
OPEB Prefund - Normal and Unfunded Liability		64.6 all funds	Pension - Unfunded Liability		154.3 GF
Total (payroll assessment funded)		177.3 all funds	OPEB Prefund - Normal		15.1 Ed Fund
			OPEB Prefund - Unfunded Liability		35.1 GF
			Total		237.4 all funds
FY23 Total Budget Impact			FY23 Budget Impact		
Address with \$10 million onetime GF in FY23, a transition year to help agencies and departments unable to absorb the increase in payroll assessment needed for FY23			Education Fund - OPEB		15.1
			Education Fund - Pension		-7.8
			General Fund - OPEB		5.5
			General Fund - Pension		-3.2
			Total		9.6

Note that all expected fiscal impacts from these changes should be viewed in relative terms and assume that all actuarial assumptions are met and all else is equal. Other factors, such as investment performance, inflation, demographics, membership size and behavior, and changes to future assumptions may create actuarial gains and losses that offset expected costs/savings from the provisions of the bill.

Table 11: Summary of Estimated Impacts by System		
<i>(\$ millions)</i>		
	State Employees	Teachers
Current System (FY 2021)		
Pension Unfunded Liabilities	1,064.4	1,950.4
OPEB Unfunded Liabilities	1,473.1	1,275.6
New State Resources		
FY 2022 General Fund - Pension	75.0	125.0
FY 2022 OPEB Prefunding One-Time	52.4 (GF)	13.3 (EF) – FY2022 5.5 (GF) – FY 2023
FY 2023 OPEB Base (all funds)	22.2	15.1 (EF)
Totals	149.6	153.4
OPEB Unfunded Liability Reduction	-891.3	-836.8
Pension Unfunded Liability Reduction		
<i>One-time funds</i>	-75.0	-125.0
<i>Benefit modifications</i>	-58.0	-35.0
<i>Total</i>	-133.0	-160.0
Total Estimated Unfunded Retirement Liability Reductions	-1,024.3	-996.8
<small>Note: Table does not reflect anticipated positive impacts of additional ADEC payments toward unfunded pension liabilities that begin in FY 2024. Estimates are preliminary and subject to change from further actuarial analysis and plan experience.</small>		

Additional Resources:

Pension Benefits, Design, and Funding Task Force

- Final Report: <https://ljfo.vermont.gov/assets/Subjects/Pension-Task-Force-Report/82821b1335/Pension-Task-Force-Final-Report.pdf>
- Website: <https://legislature.vermont.gov/committee/detail/2022/367>
- Actuarial Analysis: <https://ljfo.vermont.gov/subjects/pensions-and-state-debt/pension-task-force-report>

Pension and OPEB Actuarial and Financial Reports

- VSERS: <https://www.vermonttreasurer.gov/content/retirement/state/financial>
- VSTRS: <https://www.vermonttreasurer.gov/content/retirement/teacher/financial-reports>