GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2007

Legislative Actuarial Note

HEALTH BENEFITS

BILL NUMBER: House Bill 1114 (First Edition)

SHORT TITLE: Law Officers' 25-Year Retirement.

SPONSOR(S): Representatives Clary, McLawhorn, Glazier, and Moore

SYSTEM OR PROGRAM AFFECTED: Teachers' and State Employees' Comprehensive Major Medical Plan.

FUNDS AFFECTED: State General Fund, State Highway Fund, other State employer receipts, premium payments for dependents by active and retired teachers and State employees, premium payments for coverages selected by eligible former teachers and State employees, premium payments for coverages selected by firefighters, rescue squad workers, members of the National Guard, and certain authorized local governments.

BILL SUMMARY: Allows law enforcement officers, whom are members of either the Teachers' and State Employees' Retirement System or the Local Governmental Employees' Retirement System, to retire at the completion of 25-years of service with an unreduced benefit.

EFFECTIVE DATE: January 1, 2008

ESTIMATED IMPACT ON STATE: Bill impacts the unfunded accrued actuarial liability for the State to provide health benefit coverage to retired State law enforcement officers. The bill may also financially impact any local governments who provide local law enforcement officers with retired employee health benefit coverage. However, this legislative actuarial note does not evaluate any potential financial impact to local governments.

The consulting actuary for the Teachers' and State Employees Comprehensive Major Medical Plan (Plan), estimates the proposed bill would increase the Annual Required Contribution by $2.3 million to fund retired employee health benefit coverage on an actuarial basis. This reflects an increase of $1.5 million in the normal cost to fund the benefit and an increase in the State's accrued liability of $23.4 million.

The consulting actuary for the General Assembly, Hartman & Associates, estimates the proposed bill would increase the Annual Required Contribution by $3.287 million to fund retired employee health benefit coverage on an actuarial basis. This reflects an increase of $1.87 million in the normal cost to fund the benefit and an increase in the State's accrued liability of $41.4 million.

ASSUMPTIONS AND METHODOLOGY: The Governmental Accounting Standards Board (GASB) has adopted new standards that significantly change how public employers must measure, expense and disclose obligations for other non-pension post-employment benefits. These new standards require public employers to use actuarial valuation methods and accrual accounting conventions — similar to the way pension obligations are measured and reported — to acknowledge the accumulation of Other Post-Employment Benefit (OPEB) liabilities.

The State's OPEB Actuarial Valuation Results for Calendar Year 2005

Aon Consulting issued an actuarial valuation of the State's OPEB liabilities for projected total retired employee healthcare benefits per the standards set forth in GASB Statement Nos. 43 & 45. This actuarial valuation estimates that the State has an Unfunded Accrued Actuarial Liability (UAAL) of $23.786 billion for total projected benefits for the calendar year period ending December 31, 2005. This number represents the $23.925 billion present value estimate of total OPEB liability for health benefit coverage earned by current retired employees, current active employees, and inactive former employees eligible to retire at some point in the future minus approximately $139.175 million in current assets as of the valuation date.

The 2005 actuarial valuation also reports the Annual Required Contribution (ARC) which includes the normal cost to fund the portion of health benefits earned by current employees for calendar year 2005 plus the amount required to amortize the already accrued unfunded liability over a period of 30 years. The ARC for the State based on the 2005 actuarial valuation is $2.39 billion annually. This number comprises $850 million to amortize a year of the existing UAAL plus $1.54 billion in normal costs for benefits earned by current employees. This ARC, based on a 4.25% discount rate, is projected to fund the State's accrued obligations plus normal costs. Amortization of the UAAL is based on a level percent of pay – the amount is projected to increase each year with increases in covered payroll.

The current percent of pay contribution rate for the 2005-2006 fiscal year is equal to 3.8% payroll and has generated a reported $476.9 million for this fiscal period. An estimated 19.3% of payroll would be required to support the $2.39 billion ARC as determined in the State's actuarial valuation of retired employee health benefits.

<u>Aon Consulting</u>: The information below reflects the verbatim comments and assumptions of the Plan's consulting actuary with respect to the projection of funding need and estimate of cost reduction:

"PRICING APPROACH AND COMMENTS

Based on the bill attached, the eligibility for a pension benefit was changed for law enforcement officers such that unreduced benefits are payable upon attaining 25 years of service. This will not affect the postretirement medical benefits available to these officers, but rather the likelihood of retiring at earlier ages. We have updated the retirement probabilities in the postretirement medical valuation to reflect this change and measured the effect on the GASB obligations.

For purposes of comparison, we have calculated the effect of this change on the 12/31/2005 liability figures, as shown on page 1 of the 12/31/2005 actuarial report. The change increases the Unfunded Actuarial Accrued Liability by $23.4 Million and increases the 2006 Normal Cost by $1.5 Million. Overall, this change would increase the Annual Required Contribution by $2.3 Million.

For the postretirement medical valuation, we have used the probabilities of retirement based on the retirement assumptions used in the pension actuarial valuation. Prior to this change in unreduced retirement for law enforcement officers, the pension actuary assumed that the probability of retirement would increase the first year a participant becomes eligible for unreduced retirement. Our calculations presume that this assumption will not be changed. If these assumptions do change in the pension valuation, the effect of the change would vary accordingly in the postretirement medical valuation. The above effect of the change in unreduced retirement is based on a 4.25% discount rate, as applicable at 12/31/2005. The assumption change would have a lesser effect if the plan were funded so that a higher discount rate could be used."

<u>Hartman and Associates</u>: The information below reflects the verbatim assumptions of the General Assembly's consulting actuary with respect to the estimate of cost reduction:

"This estimate is based on the post-employment medical benefits actuarial valuation prepared as of December 31, 2005 and demographic data for law enforcement officers as of December 31, 2006. This data contained records for 3,435 state law enforcement officers, with usable data in 3,420 records. Costs are based on the projected unit credit funding method, amortization as a level percent of payroll, a 4.25% investment rate of return, and an initial medical trend of 11.0% grading to 5.0% over six years. Medical claim costs for retirees were based on Plan data for fiscal year 2006, adjusted for the projected impact of the PPO options."

SOURCES OF DATA:

-Actuarial Note, Hartman & Associates, House Bill 1114 (1st Edition), May 16, 2007, original of which is on file in the General Assembly's Fiscal Research Division.

-Actuarial Note, Aon Consulting, House Bill 1114 (1st Edition), May 1, 2007, original of which is on file with the Comprehensive Major Medical Plan for Teachers and State Employees and the General Assembly's Fiscal Research Division.

TECHNICAL CONSIDERATIONS: None

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