March 2022 Report on Other Post-Employment Benefits (OPEB)

Retirement Benefits Study Committee

March 31, 2022

STATE OF DELAWARE
RETIREMENT BENEFITS STUDY COMMITTEE
PURSUANT TO EXECUTIVE ORDER 51

To: The Honorable John C. Carney, Jr., Governor
Members of the Delaware General Assembly
Members of the Delaware Economic and Financial Advisory Council (DEFAC)

From: Rick Geisenberger, Chair and Secretary of Finance
Cerron Cade, Vice Chair and Director of the Office of Management and Budget

RE: RBSC March 2022 Report

The Retirement Benefits Study Committee (the "Committee") was established by Governor Carney in September 2019 and charged with studying options for reducing Delaware's unfunded liability for retiree health care benefits, also known as Other Post-Employment Benefits (OPEB). The Committee has now held twelve (12) public meetings.

The attached Report updates the Committee's Initial Report dated November 1, 2021 with recent activities and developments related to OPEB as well as updated Principles for Reform and Recommendations. Significant developments related to OPEB since the Interim Report include:

1) In December, Governor Carney signed Executive Order #52 which directed DEFAC to include in its calculations of the Advisory Benchmark Appropriation an "OPEB Carveout" equal to 1% of the prior year's operating budget.
2) In January, the Governor's Recommended Budget included a $47.7 million appropriation atop the regular 0.36% payroll contribution to the OPEB Trust Fund.
3) In February, the State Employee Benefit Committee voted to approve a fully-insured Medicare Advantage plan for Medicare-eligible retirees effective January 1, 2023.

Updated valuation estimates show that implementing the Medicare Advantage plan in combination with increased and sustained annual funding of the OPEB Trust Fund would result in materially improved financial outcomes and more rapid OPEB funding progress compared to current actuarial valuations. In light of these developments, the Committee updated its recommended Principles for Reform from the Interim Report to include reaching an actuarial funded ratio of at least 85% and funding 100% of the annual Actuarial Determined Contribution for OPEB by 2050 – very much akin to how the State already funds its pension liability.

The report notes that pre-Medicare retiree costs account for a material amount of the OPEB liability. The report recommends developing and implementing plans to survey and conduct focus groups, if feasible, with active employees this year to seek feedback on potential OPEB reform ideas for future pre-Medicare retirees with an eye toward implementation in 2024 or thereafter.

The Committee will continue its work and will advance further detailed recommendations and implementation guidance in future reports including a final report due March 31, 2023. A copy of this report and all materials reviewed by the Committee are available at:

https://finance.delaware.gov/financial-reports/committee-reports/retirement-benefit-study-committee/

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RBSC Findings and Recommendations

March 31, 2022

Report Background

The Retirement Benefits Study Committee (RBSC, the Committee) was established and resumed by the following authority:

Executive Order 34, signed by Governor John Carney on September 13, 2019

Executive Order 51, signed by Governor John Carney on July 21, 2021

This report of findings and recommendations has been prepared for Governor Carney, the Delaware General Assembly and the Delaware Economic and Financial Advisory Council (DEFAC) in accordance with Executive Orders Number 34 and 51, which re-established the RBSC.

The Committee was charged with studying options for reducing the unfunded liability for Other Post-Employment Benefits (OPEB) and making recommendations to the Governor, General Assembly and DEFAC. This report fulfills the requirement to provide a report on or before March 31 of 2022. A subsequent report is due in March 2023.

Committee Membership

Rick Geisenberger, Chair and Secretary of Finance

Cerron Cade, Director of the Office of Management and Budget

Ruth Ann Jones, Controller General

Joanna Adams, Director of the State Office of Pensions

Faith Rentz, Director of the Office of Statewide Benefits and Insurance Coverage

Colleen Davis, State Treasurer

Rep. John L. Mitchell, appointed by the Speaker of the House of Representatives

Rep. Ruth Briggs-King, appointed by the Minority Leader of the House of Representatives

Sen. Trey Paradee, appointed by the President Pro Tempore of the Senate

Sen. David Lawson, appointed by the Minority Leader of the Senate

Michael Begatto, Executive Director, AFSCME, Council 81, appointed by the Director of the Office of Management and Budget

Jeff Taschner, Executive Director, Delaware State Education Association, appointed by the Director of the Office of Management and Budget

One business representative appointed by the Secretary of Finance, in consultation with the Delaware State Chamber of Commerce (vacant as of the date of this report)

Summary of Committee Activity

The Committee released an Initial Report on November 1, 2021. The report along with materials and minutes from the eleven meetings of the Committee between September, 2019 and February, 2022, is available in full at: https://finance.delaware.gov/financial-reports/committee-reports/retirement-benefit-study-committee/

Summary of Committee Findings since Initial Report

Key representative findings from the materials reviewed following the November 1 Initial Report include:

- New valuation
- Improved projections resulting from new valuation
- Medicare Advantage bids
- SEBC adoption of Medicare Advantage
- Updated projections resulting from adoption of Medicare Advantage

1. The actuarial valuation for Fiscal Year 2021 reported an increased total OPEB actuarial liability and net unfunded OPEB liability. The valuation also showed an improved funded ratio as a result of significant asset gains for the OPEB Trust Fund consistent with strong market gains in the State Pension Fund during Fiscal Year 2021.

Key Results – State OPEB

(Dollar amounts in millions)	2020	2021
Actives Actuarial Liability (AL)	$ 5,179	$ 5,693
Inactive AL	4,698	5,080
Total AL	$ 9,877	$10,773
Market Value of Assets (MVA)	464	650
UAL (Total AL – MVA)	**$ 9,413**	**$10,123**
MVA Funded Ratio (MVA/AL)	**4.7%**	**6.0%**
Eligible Participant Counts*		
Active	39,308	38,986
Terminated Vested	3,959	3,931
Inactive	32,352	32,936
Total	**75,619**	**75,853**

Eligible Participants are those active employees or terminated vested in the State, Judges, or State Police Retirement Plans. Inactive participants are retirees, disableds, spouses, and surviving spouses with medical coverage.

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2. The Committee’s November 1 initial report recommended transitioning OPEB funding from pay-go to pre-funding through a variety of mechanisms including a substantial increase in recurring funding for the OPEB Trust Fund. Specifically, the Committee recommended adding a 1% Carveout to the Budget Benchmark Appropriation and Index Structure. On December 15, Governor Carney issued Executive Order No. 52 which amended Executive Order No. 21 and directed DEFAC to include a 1% Carveout in its calculation of the advisory Benchmark Appropriation. In January 2022, Governor Carney’s Fiscal Year 2023 Recommended Budget included a proposed 1% Carveout or $47.7 million Special Fund appropriation to the OPEB Trust Fund atop the current .36% of payroll contribution to the OPEB Trust Fund.

3. Applying the updated valuation results and proposed funding increases to the benefit options previously reviewed by the Committee, results in materially improved financial outcomes and more rapid funding progress compared to the prior actuarial valuation.

Funding and Benefit Options with Updated Valuation

DELAWARE DEPARTMENT OF FINANCE

		2050 Projection					
		Total Benefits	ADC	Accrued Liabilities	Trust Assets	Funded Ratio	Discount Rate
Additional Funding, 2020 Valuation	Baseline	$787	$2,486	$36,876	$3,535	9.60%	2.21%
	Baseline + 1% of Budget Index Carveout	$787	$2,024	$33,424	$9,917	29.70%	3.00%
	Eliminate Future Terminated Vesteds	$743	$1,880	$31,451	$9,917	31.50%	3.10%
	Graduated State Share Based on YOS	$787	$788	$17,185	$9,917	57.70%	7.00%
	Minimum Required Age 60/ 55	$690	$746	$16,831	$9,917	58.90%	7.00%
	HRA (2% Increase)	$566	$337	$11,055	$9,917	89.70%	7.00%
	Reduce Spousal Subsidy for Future Retirees	$681	$773	$16,882	$9,917	58.70%	7.00%
	Combination	$379	$142	$5,859	$5,670	96.80%	7.00%
Additional Funding, 2021 Valuation	Baseline (Updated Experience and Trust Assets)	$842	$2,466	$37,022	$4,626	12.50%	2.16%
	Baseline + .36% of Payroll Appropriation	$842	$2,439	$37,022	$5,682	15.80%	2.16%
	Baseline + 1% of Budget Index Carveout	$842	$964	$19,088	$9,818	51.40%	7.00%
	Baseline + Appropriation + Carveout	$842	$910	$19,094	$10,874	56.90%	7.00%
	Eliminate Future Terminated Vesteds	$798	$837	$18,153	$10,874	59.90%	7.00%
	Graduated State Share Based on YOS	$842	$659	$15,874	$10,874	68.50%	7.00%
	Minimum Required Age 60/ 55	$727	$601	$15,444	$10,874	70.40%	7.00%
	HRA (2% Increase)	$602	$338	$11,339	$10,874	95.90%	7.00%
	Reduce Spousal Subsidy for Future Retirees	$730	$675	$15,979	$10,874	68.10%	7.00%
	Combination	$424	($92)	$6,189	$10,874	175.70%	7.00%

Note: All benefit options reflect the lowest funding row in gray immediately above

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4. The Committee reviewed information considered by the State Employee Benefits Committee (SEBC) in reviewing responses to the SEBC's RFP for Health Third Party Administrative Service. Responses to the RFP showed that proposed fully-insured Medicare Advantage (MA) plans would provide similar coverages and provider networks as the current self-insured Medicfill plan.

Medicare pensioner plan options

Overview of proposed options – Medicfill vs Group MA

Plan feature	Medicfill (current)	Proposed Group MA (Aetna)	Proposed Group MA (Highmark)
Plan type	▪ Self-funded medical/EGWP	▪ Fully-insured MA (medical only) or MAPD	▪ Fully-insured MA (medical only) or MAPD
Federal funding	▪ Retained by GHIP (EGWP only)	▪ Retained by Aetna	▪ Retained by Highmark
Medical plan design[1]	▪ Member responsible for Part B premium only ($170.10/month for 2022)	▪ Same as Medicfill	▪ Same as Medicfill
Rx plan design[2]	▪ Generic copay: $8 / $16 retail/mail ▪ Brand formulary: $28 / $56 ▪ Brand non-formulary: $50 / $100 ▪ Out-of-pocket max: None[3]	▪ Same as Medicfill	▪ Same as Medicfill
Provider network	▪ Passive PPO (members may seek care from any medical provider that accepts Medicare assignment)	▪ Same as Medicfill ▪ Mirrors access to providers available today	▪ Same as Medicfill ▪ Mirrors access to providers available today

1. Plan fully covers medical out-of-pocket costs not covered by Medicare Part B, other than the Part B premium
2. Prescription drug copays and 5% premium cost share applies for pensioners retiring on or after 7/1/2012; State share is 100% for pensioners retiring before 7/1/2012; State pays 100% of State Share for pensioners with 20+ years of service
3. Catastrophic Coverage: After yearly out-of-pocket drug costs reach $7,050, retirees pay the greater of 5% coinsurance or from $3.95 to $9.85 copayment per script based on drug tier

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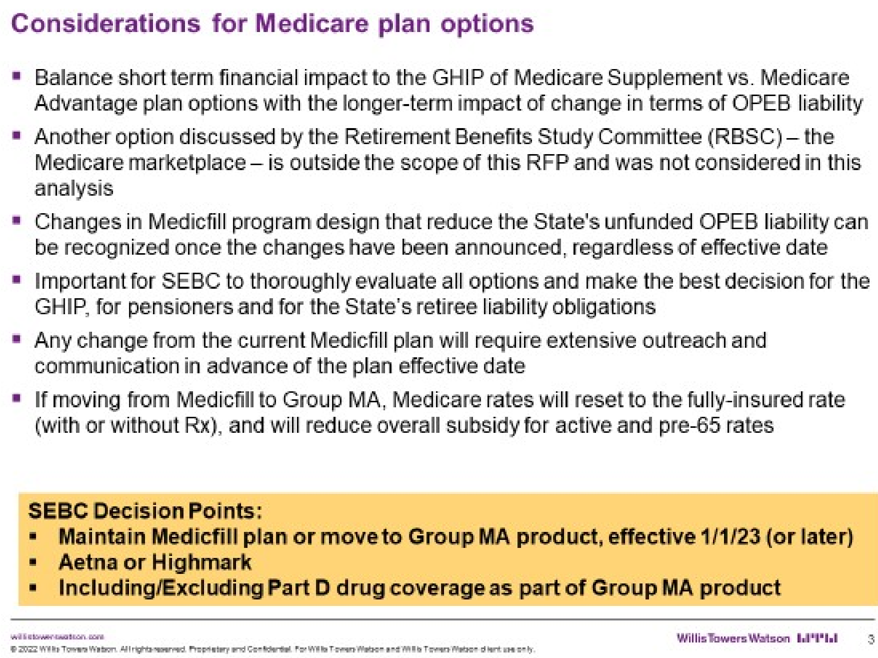
5. After a review of the below considerations, the SEBC voted to approve implementation of an MA plan effective January 1, 2023, at its February 28, 2022 meeting. As noted below, this decision also allows related reductions in the OPEB liability to be recognized.



6. The November 1 Initial Report recommended a three-part approach to addressing the State's unfunded liability as follows:
    - Increased funding for the OPEB Trust Fund;
    - Transitioning coverage of Medicare-eligible retirees from the Medicare Supplement to an employer-sponsored Medicare Advantage Plan or an indexed employer subsidy funded through a Health Reimbursement Account (HRA); and
    - Modifying eligibility requirements for active and future employees.

   The combination of a sustained increased funding (as proposed in the Governor's Recommended Budget) and implementation of a Medicare Advantage Plan would result in funding a significant portion of the OPEB liability by the end of a 30-year valuation period. In addition, modifying benefit eligibility for active and future employees, with grandfathering of active employees hired before 2012, would result in funding roughly 90-100% of liability over a 30-year valuation period.

Indicative Actuarial Estimates

		2050 Projection					
		Total Benefits	ADC	Accrued Liabilities	Trust Assets	Funded Ratio	Discount Rate
Benefit Eligibility Changes Combined with MA	Baseline (Updated Experience and Trust Assets)	$842	$2,466	$37,022	$4,626	12.5%	2.16%
	Baseline + .36% of Payroll Appropriation	$842	$2,439	$37,022	$5,682	15.8%	2.16%
	Baseline + 1% of Budget Index Carveout	$842	$964	$19,088	$9,818	51.4%	7.00%
	Baseline + Appropriation + Carveout	$842	$910	$19,094	$10,874	56.9%	7.00%
	Medicare Advantage w $0 / Month Premium	$629	$552	$13,971	$10,874	77.8%	7.00%
	Graduated State Share Based on YOS [1]	$626	$405	$12,159	$10,874	89.4%	7.00%
	Minimum Required Age 60/ 55 [1]	$514	$267	$10,742	$10,874	101.2%	7.00%
	Reduce Spousal Subsidy for Future Retirees [1]	$579	$397	$12,128	$10,874	89.7%	7.00%

[1] Benefit eligibility modification applied to employees hired on or after 1/1/2012

Note: All benefit options reflect the appropriation plus 1% carveout funding

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7. Implementation of the MA plan alone or when combined with other benefit options results in significant reductions in accrued OPEB liabilities compared to the baseline 2050 projected accrued liabilities of $37.0 billion. However, enhanced sustained funding is required to achieve increases in the actuarial discount rate and funded ratios of > 50% by the end of the projection period.

Funding and Benefit Options Assuming MA

Presented with and without the 1% of Budget Index Carveout Additional Funding

		2050 Projection					
		Total Benefits	ADC	Accrued Liabilities	Trust Assets	Funded Ratio	Discount Rate
1% of Budget Index Carveout NOT Included	Medicare Advantage w $0 / Month Premium	$629	$1,703	$25,487	$5,682	22.30%	2.16%
	Eliminate Future Terminated Vesteds	$594	$1,596	$24,111	$5,682	23.60%	2.16%
	Graduated State Share Based on YOS [1]	$626	$1,450	$22,112	$5,682	25.70%	2.16%
	Minimum Required Age 60/ 55 [1]	$514	$1,323	$20,793	$5,682	27.30%	2.16%
	Reduce Spousal Subsidy for Future Retirees [1]	$579	$1,432	$21,487	$5,682	26.00%	2.16%
1% of Budget Index Carveout Included	Medicare Advantage w $0 / Month Premium	$629	$552	$13,971	$10,874	77.80%	7.00%
	Eliminate Future Terminated Vesteds	$594	$497	$13,314	$10,874	81.70%	7.00%
	Graduated State Share Based on YOS [1]	$626	$405	$12,159	$10,874	89.40%	7.00%
	Minimum Required Age 60/ 55 [1]	$514	$267	$10,742	$10,874	101.20%	7.00%
	Reduce Spousal Subsidy for Future Retirees [1]	$579	$397	$12,128	$10,874	89.70%	7.00%

[1] Benefit eligibility modification applied to employees hired on or after 1/1/2012

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8. Eliminating future terminated vested employees from receiving OPEB benefits, when added to enhanced funding, implementation of MA, and one of the three remaining benefit options analyzed, can result in effectively fully funding the liability by the end of the 30-year period.

Funding and Benefit Options Assuming MA

Presented with and without the 1% of Budget Index Carveout Additional Funding AND assuming future terminated vesteds do not receive benefits effective 1/1/24

		2050 Projection					
		Total Benefits	ADC	Accrued Liabilities	Trust Assets	Funded Ratio	Discount Rate
1% of Budget Index Carveout NOT Included	Medicare Advantage w $0 / Month Premium	$629	$1,703	$25,487	$5,682	22.30%	2.16%
	Graduated State Share Based on YOS [1]	$591	$1,345	$20,664	$5,682	27.50%	2.16%
	Minimum Required Age 60/ 55 [1]	$479	$1,327	$19,100	$5,682	29.70%	2.16%
	Reduce Spousal Subsidy for Future Retirees [1]	$547	$1,432	$20,391	$5,682	27.90%	2.16%
1% of Budget Index Carveout Included	Medicare Advantage w $0 / Month Premium	$629	$552	$13,971	$10,874	77.80%	7.00%
	Graduated State Share Based on YOS [1]	$591	$340	$11,323	$10,874	96.00%	7.00%
	Minimum Required Age 60/ 55 [1]	$479	$205	$9,816	$10,874	110.80%	7.00%
	Reduce Spousal Subsidy for Future Retirees [1]	$547	$339	$11,321	$10,874	96.10%	7.00%

[1] Benefit eligibility modification applied to employees hired on or after 1/1/2012

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9. Enhanced funding would both increase the assets available for benefits and reduce the calculation of accrued liabilities by allowing higher discount rates to be applied to the actuarial valuation. The implementation of MA is projected to reduce 2050 liability by $11.5 billion. The Committee previously reviewed that roughly 30% of OPEB liability is attributable to pre-65 retirees and adopted the principle that benefit changes should be applied equitably to pre-65 and Medicare-eligible retirees. Among the other benefit options analyzed, with grandfathering of employees hired before 2012 included, the minimum age requirement or any of the three eligibility options analyzed combined with elimination of terminated vested benefits would reduce 2050 liability in an equitable proportion.

Summary of Options

Estimated Impact of Funding and Benefit Options, Assuming Medicare Advantage 1/1/23

Benefit Eligibility Modifications Applied to Retirements of Employees Hired on or after 1/1/2012, Effective 1/1/24

Funding	Terminated Vesteds Eligible for Benefits Post-1/1/24	Benefits	Funded Ratio: 2050	Accrued Liabilities: 2050 ($ in Millions)	Projected Year Discount Rate Equals 7%
Current	Yes	Current Benefits	22.3%	$25,487	n/a
Current	Yes	Modified State Share Based on YOS	25.7%	$22,112	n/a
Current	Yes	Minimum Required Age 60/ 55	27.3%	$20,793	n/a
Current	Yes	Reduce Spousal Subsidy	26.0%	$21,487	n/a
Current	No	Current Benefits	23.6%	$24,111	n/a
Current	No	Modified State Share Based on YOS	27.5%	$20,664	n/a
Current	No	Minimum Required Age 60/ 55	29.7%	$19,100	n/a
Current	No	Reduce Spousal Subsidy	27.9%	$20,391	n/a
Enhanced	Yes	Current Benefits	77.8%	$13,971	2036
Enhanced	Yes	Modified State Share Based on YOS	89.4%	$12,159	2032
Enhanced	Yes	Minimum Required Age 60/ 55	101.2%	$10,742	2031
Enhanced	Yes	Reduce Spousal Subsidy	89.7%	$12,128	2032
Enhanced	No	Current Benefits	81.7%	$13,314	2036
Enhanced	No	Modified State Share Based on YOS	96.0%	$11,323	2033
Enhanced	No	Minimum Required Age 60/ 55	110.8%	$9,816	2031
Enhanced	No	Reduce Spousal Subsidy	96.1%	$11,321	2033

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Committee Principles for Reform

The November Initial Report included Principles for Reform. The Principles are included below. Based on the updated 2021 valuation results and further scenario analysis, the Committee determined that Principle VIII should be updated to reflect faster progress toward addressing the OPEB unfunded liability and align OPEB funding progress more along the lines of the pension system:

I. Provide retiree health care benefits for career employees that are affordable to the retiree, comparable to those offered by similar government employers, and can be sustainably maintained within the long-term resources made available to the State by its taxpayers, without placing pressure on public services or the state's financial strength and creditworthiness.

II. Preserve benefit eligibility and comparable level of coverage for career employees that have already retired or are near retirement.

III. Provide a benefit that is transparent, understandable, predictable, and accessible.

IV. Provide quality customer service and education to assist retirees with structural changes or transitions.

V. Implement steps to reduce the unfunded OPEB liability through a combination of enhanced recurring funding above pay-go funding, benefit reforms, and increases in the actuarial discount rate as a result of such changes. The magnitude of benefit savings generated by reform should be of at least equal magnitude to enhanced funding within an actionable timeframe, e.g., within five to ten years of adopting reforms.

VI. Transition OPEB funding from pay-go funding to the pension funding model, which uses current taxpayer resources to pre-fund future liabilities as they are earned by employees, by enhancing the current budgetary pre-funding of 0.36% of payroll. Possible mechanisms would include an OPEB Trust Fund Carveout from the Budget Benchmark Appropriation and Index structure, and/ or a gradual scheduled increase in the percentage of payroll pre-funding amount, within actuarially determined levels.

VII. Target benefit reforms to be as minimally disruptive to career employees as possible, and to balance expected savings equitably in proportion to the costs and liabilities generated by retirees receiving pre-Medicare and Medicare medical benefits.

VIII. Through the combination of principles above, demonstrate meaningful improvement by reaching an actuarial funded ratio of OPEB liabilities of at least 85% by 2050, including funding 100% of the Actuarially Determined Contribution (ADC), and demonstrate interim progress toward that objective by reaching an actuarial funded ratio of at least 35% by 2033, and 100% of the ADC.

IX. Evaluate the current benefit and premium-sharing structure to identify opportunities to bring cost growth in line with inflation by introducing consumer choice and plan flexibility. This potentially includes such mechanisms as: providing retirees an indexed employer contribution to purchase coverage, such as in the individual Medicare marketplace; or, changing the statutory premium-sharing formula from a structure that defines and limits retiree contributions to one that limits employer contributions within fixed ranges as a percent of payroll, and requires changes in benefits and/ or retiree contributions when the ranges are exceeded.

X. Benefit reforms that would impact eligibility of active or future employees should be evaluated within the context of overall employee compensation and consider trends in salaries and other compensation.

Committee Recommendations

Executive Order 51 directs the Committee to report on findings and recommendations by March 31 of 2022 and 2023, in addition to the Initial Report provided in November. The Committee may provide additional “interim reports as requested or as the Committee deems prudent.”

At this time, the Committee recommends the following steps to continue to advance the recommendations presented in the Initial Report:

I. Increase funding for the OPEB Trust Fund by:

    a. Adopting a substantial increase in recurring funding by incorporating the 1% Carveout within the Benchmark Appropriation as outlined in Executive Order 52 issued by Governor Carney in December 2021 and as included in the Governor’s Recommended Budget for Fiscal Year 2023.

b. Provide additional one-time contributions when circumstances such as one-time revenues or surpluses permit, similar to Section 16 (Escheat – Special Funds) of the FY 2022 Bond and Capital Improvement Act (SB 200).

II. Support the SEBC's rollout in 2022 of the Medicare Advantage plan for Medicare-eligible retirees effective January 1, 2023. Monitor realized savings and public employer trends over the next 5 years to determine the potential future desirability and feasibility of Health Reimbursement Arrangements.

III. Continue to review other benefit options addressing pre-Medicare retiree eligibility, noted to be 30% of the total liability in the Initial Report. Develop and implement a plan to educate active members on the issues, challenges and opportunities highlighted in the Findings and Principles for Reform sections of the Initial Report and this report and gain feedback on options under consideration through meetings, an employee survey to be conducted in calendar year 2022, and a series of focus groups of representative employees, if determined by the Chair to be feasible. Options for potential implementation effective January 1, 2024 or thereafter could include one or more of the following options or variations thereof:

   a. Reduce the State share/ subsidy for spouses of retirees from 100% to 50% for future retirees after a certain effective date, for those that have not reached retirement eligibility status.

   b. Modify the eligibility schedule for State share/ subsidy for those hired since 1/2007 to 20 years of service = 50%, 25 years = 75% and 30 years = 100%, after a certain effective date.

   c. Establish a minimum age to enroll on the retiree medical plan of 60 for State Employees and 55 for employees subject to a mandatory retirement age, providing a deferred benefit for those that retire prior to the minimum. This would apply after a certain effective date, for those that have not reached retirement eligibility status.

   d. Eliminate the ability to access retiree medical benefits for vested employees that terminate their State service without filing with the Pension Office for retirement. This would apply to employees that terminate after a certain effective date and require employees in the future to retire from State service in order to receive the retiree medical benefit.

IV. Work with the SEBC and State Pension Office to consider other means of reducing pre-65 liability such as having pre-65 retirees assume higher implicit costs or inflationary growth of premiums.

V. Following completion of the survey and focus groups (if conducted) and additional review and discussion by the Committee and stakeholders, advance further detailed recommendations and implementation guidance in the additional report required by March 31, 2023 or in an interim report prior to that date for inclusion in the Governor's Fiscal Year 2024 Recommended Budget.