LEAH VUKMIR
STATE SENATOR

Senate Bill 48
Senate Economic Development and Local Government Committee
March 6, 2013

Thank you, committee members, for joining me today for this public hearing on Senate Bill 48. This legislation simply requires local governments to fully fund their commitments to post-retirement health insurance benefits for anyone hired after January 1st, 2014.

With the downturn in the economy, everyone has become aware of budget deficits hitting the federal, state, and local governments. Added attention has also been placed on the solvency of our retirement fund. Wisconsin has been lucky to have a fully funded pension system that is the envy of our neighbors. However, not enough attention has been paid to the massive deficits that have been created by local governments offering to pay some or all of an employee's post-retirement health care.

In Milwaukee, the problem is especially alarming. For Milwaukee County, there is a net deficit of over $250 million, with it growing anywhere from $40 to $60 million a year. For the City of Milwaukee, the net deficit is $213 million with annual deficits over $30 million. Milwaukee Public Schools are facing an even more difficult situation. While they have taken steps to limit last year's deficit, our state's largest school district has an ongoing deficit of nearly $523 million. Residents of Milwaukee are staring at future costs of over $980 million that will come due as more and more government employees decide to retire early. This could lead to massive budget cuts or huge property tax increases at the local level. In the year and a half since we first introduced this legislation, that number has grown by over $200 million.

What we are asking for is not out of line. We simply want local governments that provide post-retirement health care benefits to pay for them. Right now, a city council can approve these benefits to buy labor peace today, knowing they may never have to find a funding source to pay for them. It is time to require those that approve the benefits pay for those benefits.

Thank you for your time, and I urge you to support SB 48.

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Jeremy Thiesfeldt
STATE REPRESENTATIVE • 52nd ASSEMBLY DISTRICT

Testimony on AB23/SB48

March 6, 2013

Rep. Jeremy Thiesfeldt

I am here today to urge your support for AB23/SB48 , The Responsible Retirement Budgeting Bill.

This bill deals with a category of benefits that has been offered to the employees of local units of government classified as "Other Post-Employment Benefits" (OPEB). The benefits of this type can be as many and varied as the number of communities in the state that offer them. They are offered to employees who are retiring prior to reaching medicare/social security age.

I was unable to uncover any clearinghouse for data on the number of local units of government that offer a post-retirement healthcare benefit. A small random sampling suggests that many communities do not offer any OPEB at all.

The Wisconsin Statutes allow for funding of OPEB in two ways, 1) actuarial, or 2) pay-as you go. The latter method is the predominant choice of local units of government statewide that offer such benefits. It requires the local unit of government to annually examine the number of potential beneficiaries and find a way to fund the promise.

Under this bill the long-term security of OPEB for employees of local governments would be assured by requiring the benefit to be funded on an actuarial basis for all new employees. Additionally, it would also assure that should a single budget cycle bring a large number of retirements, it would not cause a sudden increase in local property taxes or drastic service reductions to fund the spike in benefit claims. This is especially evident in the current environment of revenue limits.

What are some examples of OPEB? They are primarily unused accumulated sick leave that is converted to pay for extended health care after retirement. Each local unit of government has created these varied benefits as they found necessary. However, it should be noted clearly that this bill does not involve pensions, nor does it cover the cost of the "implicit rate subsidy" for post-retirement healthcare.

Serving the City of Fond du Lac and the Communities of North Fond du Lac, Eldorado, Taycheedah and Friendship

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For example, the Village of Pewaukee has offered exclusively to retired police officers a health care benefit that pays 25% of premiums for life or until the beneficiary voluntarily drops from the plan. Increasing life expectancies could play a role in the uncertainty of funding this OPEB on a pay-as-you-go basis.

Until recently, Richmond School District allowed retired employees to receive a full five years of district-paid health and dental benefits, 403(b) contributions, life insurance, and a $6800 annual stipend. These OPEB, among others, amounted to an annual package of up to $150,000. These benefits were obviously unsustainable, particularly under the pay-as-you-go option.

My home community, the City of Fond du Lac, also uses the pay-as-you-go method. The city's Comprehensive Annual Financial Report (CAFR) for 2011 shows a growing unfunded net obligation for its "sick time conversion benefit" of nearly $2.18 million in liabilities. This liability has doubled since 2009.

If funding on an actuarial basis were required, the money for OPEB would accumulate in a bank account. Local units of government would have to annually set aside money as it is accrued by employees. If an employee found other employment prior to receiving any of the benefit, this would create a positive account balance to further ensure the viability of the program.

With this change, local officials would not be able to push these costs onto future budgets, thereby handcuffing future elected bodies. Elected officials who grant OPEB for future retirees will be accountable for funding it now.

Almost entirely, large unfunded liabilities exist in the Comprehensive Annual Financial Reports (CAFR) of local units of government that offer OPEB and fund them "pay-as-you-go." Valid concerns have been raised by some local units of government that this bill would initially be a huge financial burden. Therefore, as stated earlier, AB23/SB48 would only apply to new employees. This will create minimal expense up front and allow a smooth transition until the entire workforce falls under the actuarial model.

A valid question that I am often asked, is why not include the state as well? Pages 136-140 of the 2012 WI CAFR defines the four OPEB the state currently offers:

1) Retiree Health Insurance
2) Retiree Life Insurance
3) Protective Occupation Duty Disability Insurance
4) Accumulated Sick Leave Conversion Credits

Page 136 directly states that the retiree health insurance plan is funded on a pay-as-you-go basis. Retirees are allowed to pay the same premiums as current employees creating an "implicit rate subsidy" for retirees. As of January 1, 2011 the subsidy totaled $953 million. This subsidy increases overall plan costs due to increased services to the age bracket of the retirees. The plan is fully funded by premiums. Retirees may pay for the premiums in cash or apply unused sick leave credits toward their premium. The State of Wisconsin's unused sick credits are currently prefunded at 99.3% on an actuarial basis.

Retiree Life Insurance and Duty Disability Insurance are both on target to be fully funded actuarily. I also have a letter from Secretary Robert Conlin of WI Employee Trust Funds that gives details of the state OPEB. His conclusion (as well as that of the previous Secretary, David Stella) is that including the state in the legislation would have no effect on funding of state OPEB.

Another concern expressed centered on the cost an actuarial study may have on a small municipality and how often one would be required. A typical actuarial study costs around $3000-$6000. Government Accounting Standards Board (GASB) regulations recommend if a municipality of over 200 employees offers a post retirement benefit they should file a report every 2 years. GASB recommends those under 200 require a report every 3 years. I have an amendment drafted and ready that would only require an actuarial study at least once every four years.

In conclusion, to be fiscally prudent with taxpayer resources we need to require municipalities, school districts, counties and technical colleges districts to prefund promised benefits through a periodic actuarial study. Adjustments to allow for adequate time to meet the goal of actuarial funding have been included in the bill. If a community offers benefits to employees, we have an obligation to provide oversight that the benefits are truly funded.

City of Milwaukee

Department of Administration
Intergovernmental Relations Division

Tom Barrett
Mayor

Sharon Robinson
Director of Administration

Jennifer Gonda
Director of Intergovernmental Relations

March 6, 2013
Senate Committee on Economic Development and Local Government

Testimony regarding Senate Bill 48:
Relating to funding postretirement health care benefits of local government employees.

Presented on behalf of Mark Nicolini, Budget & Management Director

Thank you Chair Gudex and committee members for the opportunity to testify today. Allow me to begin by saying that the City of Milwaukee supports responsible funding of public employe retirement benefits.

- Multiple 3rd party analyses reveal that the Milwaukee's Employes' Retirement System (ERS) has one of the strongest funded positions among U.S. public employe retirement systems (PERS). As of January 1, 2012, ERS had a funded ratio of 96%, compared to an average of approximately 75% for the largest public retirement systems. ERS is funded on an actuarial basis. The City made $49 and $60 million employer contributions in the 2010 and 2013 City Budgets, respectively by, among other actions, cutting operating spending by more than $43 million—unlike many other systems that neglected to make their actuarially-required contributions.

- In 2012, the Common Council and Mayor agreed on significant changes to the City's health care benefits that will affect both active employes and those who retire as of January 1, 2012:

    - General city retirees will pay 12% of the applicable premium and be subject to annual deductibles of $500 for single plans and $1,000 for family plans. Retirees will be subject to future plan design changes.
    - Protective service retirees will be subject to the same deductible and co-pay provisions as general city employes. (However, the Police portion is currently under litigation.)
    - In addition, it has been a longstanding City policy to support only 25% of Medicare-eligible retirees' supplemental insurance premiums.

These recent changes have improved the City's OPEB liability significantly. In two years, our OPEB liability has decreased by 13%. Further changes are pending that will further improve this figure.

The City is concerned about the implications of this legislation. Our concerns are as follows:

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1. Similar to the State, the City currently funds these benefits on a pay as you go basis. Assuming an annual average of 100 combined police and fire new recruits, and 100 new general city employes, the actuarial funding requirement is estimated to be $1.2 million on a fully-annualized basis, and would grow annually. This would add to the $13 million reduction in state aids the City has received since 2011.

2. The City could eliminate the benefit for new general city hires, but our current bargaining contracts with our protective service unions include this benefit for all new hires. The only way to remedy this problem is to amend Wis. Stat. 111.70(4)(mc) to add a seventh paragraph. That paragraph would make postretirement healthcare benefits a prohibited subject of collective bargaining. Without this change, the City is in no position to eliminate the benefit unilaterally from newly-hired police officers and firefighters.

   This requirement would impose substantial new funding requirements without any means to eliminate the benefit for the employe categories that generate the great majority of the City's OPEB liability. Sworn police and firefighters make up more than 60% of the City's operating salaries and close to 70% of OPEB liability. Their portion of the OPEB liability is higher because of a generous retirement provision that allows them to retire after 25 years of service, regardless of age.

3. The City is operating under levy limits and significant declines to its state aids, and cannot adjust its budget to accommodate an actuarial funding requirement. If the legislation is not modified to exempt additional costs related to this requirement from levy limits, we will be required to reduce services even further.

The City of Milwaukee is making meaningful <u>local</u> progress on reducing OPEB liability via the recent changes to health benefit premiums and employe cost-sharing that will affect new retirees. We balance our budget annually and have funded our pension and OPEB obligations without resorting to borrowing.

Attached you will find the Executive Summary of our most recent OPEB valuation report.

Thank you for your consideration.

EXECUTIVE SUMMARY

This report presents the results of our actuarial valuation as of January 1, 2011, for the Retiree Healthcare and Life Insurance Programs sponsored by the City of Milwaukee. The valuation was performed to satisfy the reporting requirements of GASB Statement Nos. 43 and 45. Our valuation was based on a discount rate assumption of 4.5 percent and an ultimate healthcare trend assumption of 4.5 percent[1], as approved by the City of Milwaukee. The discount rate reflects the employer's pay-as-you-go funding policy. The key valuation results using the Projected Unit Credit cost method are summarized below:

Retiree Healthcare and Life Insurance Programs
4.5% Discount Rate and 4.50%[1] Ultimate Trend
$ in Thousands

	General	Police	Fire	Total
Actuarial Liability as of January 1, 2011	$321,147.3	$386,093.9	$209,142.2	$916,383.4
Normal Cost for FY 2011	$10,979.2	$18,233.1	$7,675.7	$36,888.0
Annual Required Contribution FY 2011	$23,243.2	$32,977.3	$15,662.4	$71,882.9
(% of Payroll)	11.5%	26.1%	27.8%	18.7%
GASB No. 45 FY 2011 Expense	$23,524.4	$33,611.1	$15,935.1	$73,070.6
(% of Payroll)	11.7%	26.6%	28.3%	19.0%
FY 2011 Employer Pay-go Contribution	$15,719.6	$11,654.5	$7,171.0	$34,545.1
(% of Payroll)	7.8%	9.2%	12.7%	9.0%
Payroll	$201,697.4	$126,170.2	$56,290.5	$384,158.1
Number of Active Members	4,226	1,914	858	6,998
Number of Retirees and Surviving Spouses	2,108	1,234	733	4,075

The details of the preceding valuation results by employee group are included in Section B of the report. The valuation was performed for City of Milwaukee employees eligible for retiree healthcare and life insurance benefits, which generally includes participants in the City of Milwaukee Employees' Retirement System except for Milwaukee Public Schools employees. The valuation excludes Redevelopment Authority of the City of Milwaukee (RACM) and Housing Authority of the City of Milwaukee (HACM) employees, as they are reported separately.

Our calculations are based on adoption at January 1, 2007, and an opening transition liability of zero at that date. The Net OPEB Obligation or balance sheet liability represents the cumulative differences between Annual OPEB Costs and actual employer contributions.

[1] *Excess trend rate over 4.50% in 2021 and after of 0.25% for the PPO Plan and 0.30% for the EPO Plan applied to claims costs to account for the Excise Tax under Health Care Reform Act.*

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MEMORANDUM

TO: Honorable Members of the Senate Committee on Economic Development and Local Government

FROM: Kyle Christianson, Legislative & Research Associate KC

DATE: March 6, 2013

SUBJECT: Senate Bill 48 – Postretirement Health Benefits

Under current law, local governments have the option of funding postretirement health care benefits on a pay-as-you-go schedule. Senate Bill 48 requires local governments to fully fund these benefits—for new employees—on an actuarial basis or according to generally accepted accounting principles.

While the Wisconsin Counties Association (WCA) recognizes the "best practice" intent of the legislation, we ask the committee to consider the potential impact this legislation may have on counties and other units of local government. County governments have long prioritized and maintained their commitments to retirees by funding postretirement obligations in locally determined ways that are efficient and financially responsible for each individual county's unique circumstances. The state's current law has worked well for counties, who have discretion in determining how to fund these benefits, and retirees who receive these benefits.

According to county finance directors, changes in local discretion with regard to these benefits may result in additional bookkeeping, administrative, and actuarial costs. These costs will be difficult for counties to absorb with declining state aids and unprecedented restrictions on property taxes.

WCA has not taken a position in support or opposition of Senate Bill 48 but encourages the Committee in its review of this legislation to consider its impact on local finances and local control.

Thank you for considering our comments. Please feel free to contact WCA for further information.

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To: Senate Committee on Economic Development and Local Government
From: Curt Witynski, Assistant Director, League of Wisconsin Municipalities
Date: March 6, 2013
Re: SB 48, Requiring Local Governments to Fund Post-Retirement Health Benefits on an Actuarial Basis

The Board of Directors of the League of Wisconsin Municipalities has not yet had an opportunity to determine its position on SB 48, prohibiting local governments from providing post-retirement health care benefits to any employee hired after the bill's effective date unless the benefit is fully funded on an actuarial basis. I'm offering this testimony for information purposes only. Last session, the League opposed a similar bill due to cost concerns. We have the same concerns with this bill.

While we don't know the exact number, many municipalities over 10,000 in population provide post-retirement health benefits to at least some of their employees, particularly police and fire. Municipalities almost exclusively fund the cost of post-retirement health insurance benefits on a pay-as-you-go basis, paying the current costs of health insurance premiums for covered retirees each year. For cities like Eau Claire and Beloit that cost is approximately $2.2 million annually.

SB 48 requires municipalities to permanently set aside sufficient funds to cover the future costs of post-employment health insurance premiums for individuals hired by the municipalities after the effective date of the bill.

Over time, the cost to some municipalities of complying with SB 48 would be excessive and simply unworkable. The City of Eau Claire has received estimates from its actuary that helps illustrate the fiscal impact of this bill on municipalities. Eau Claire estimates that in order to fully fund on an actuarial basis a newly hired 25 year old fire fighter or police officer's post-employment health care benefit it would have to set aside $195,000. For a newly hired general employee of the same age the amount would be $40,000 to $45,000. In 2012, the City hired 20 public safety officers and 18 general employees. The City would have had to have placed $4,620,000 in a trust to "fully fund" the post-employment health insurance for the 2012 new hires if SB 48 had been in place. The money would remain in the trust account regardless of whether the employees continued working for the city. The $4.62 million would have been in addition to the approximately $2 million that the City pays out for retiree health insurance on a pay as you go basis.

One question we have regarding the bill is what does "fully funded on an actuarial basis" mean? Does it mean that the entire $195,000 per public safety officer has to be in the segregated account at the date of hire, or does the bill intend that the City must start to fund the post-employment benefit on an actuarial basis at the date of hire, requiring, for example, that the City start setting aside $10,000 per year per new employee hired, with the goal of having the benefit fully funded at the new employees' retirements? Under the latter interpretation, the City would have had to deposit in the trust in 2012 perhaps $250,000 for the new hires. Even under this interpretation, the bill is burdensome, especially since municipalities are operating under strict levy limits. Eau Claire points out that the payments would escalate over the years. In the second year, the City would need to make a deposit for the 2nd year new hires, plus make the next $250,000 installment for the 1st year new hires, all in addition to the pay as you go amount. By year 4, the City would be paying into the trust over a $1,000,000 and the amount would continue to escalate.

Finally, even if a municipality wanted to drop post-employment health coverage for new employees, it could not unilaterally do so for police and fire employees since these employees retain full collective bargaining rights.

At the very least, the committee should consider delaying the effective date of the bill to January 1, 2015, to allow communities time to bargain the issue with their police and fire employees.

Thanks for considering our comments.