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Before the Joint Standing Committee on
Appropriations and Financial Affairs

LD 1312, "An Act to Provide a Source of Revenue for School Construction and for the Land for Maine's Future Trust Fund"

November 14, 2025

Good afternoon, Senator Rotundo, Representative Gattine, and members of the Joint Standing Committee on Appropriations and Financial Affairs. I am Doug Cotnoir, State Controller. I am here today to testify Neither For Nor Against LD 1312, An Act to Provide a Source of Revenue for School Construction and for the Land for Maine's Future Trust Fund.

Our understanding is that this LD would redirect 50 percent of the investment earnings from the Budget Stabilization Fund (BSF) in any month in which the BSF is at its statutory limit, to fund school construction. The remaining 50 percent would be split evenly between the Land for Maine's Future Trust Fund (LMF) and Other Post-Employment Benefits Trusts (OPEB). Currently, 100 percent of those investment earnings are directed to the OPEB Trust for the State Employee Plan (OPEB-SEP).

<u>OPEB UAL and the statutory requirement to liquidate</u>:

There exists an unfunded liability of the retiree health insurance plans for state government workers, teachers and first responders. An unfunded liability is a financial obligation for which sufficient funds have not been set aside to cover future expenses, posing risks to financial stability and ability to meet health care expenses. This is an obligation of the state of nearly $1.2 billion that is meant to be liquidated by 2037 per statute. To figure out and liquidate the retiree health UAL means an increased commitment from the General Fund, increased premium costs to the retirees, the need to reduce health insurance benefits, extending the liquidation timeline – or a mix of any of the above.

It is important to note that this UAL is separate and distinct from the retirement system UAL that will be liquidated, per Maine's Constitution, at the end of fiscal year 2028.

The OPEB UAL balances as of June 30, 2024 are: $292M – State Plan, $857M – Teacher Plan, $29M– First Responder Plan *(offset in part by a $24 million investment trust account)*. June 30, 2024 is the most recent data. The annual actuarial valuation (update) is underway now.

<u>Investment earnings used to pay down some of OPEB</u>:

When the BSF is *below* its statutory limit of 18% of General Fund revenue of the immediately preceding year, monthly investment earnings accrue to the BSF. In PL 2023, c. 412, Part I, (further clarified in PL 2023, c. 643), the Administration proposed and the Legislature updated the relevant statute - 5 MRS §1532 (5) – such that interest earnings when the Budget Stabilization Fund (BSF) is *at* its statutory limit be distributed to the State worker retiree health plan UAL (OPEB-SEP). This was suggested and necessary because current contributions were not reducing the existing UAL balances at a fast enough rate and the requirement that they be retired by 2037 is looming. This was an opportunity to address this outstanding balance.

Prior to PL 2023, c. 643 there was only $2 million from the Year End Cascade being devoted to meeting this $1.2 billion obligation annually. Applying the BSF earnings toward this purpose has proven an effective strategy, especially given that the OPEB Trust is invested with more market exposure and earns a significantly higher rate of return than the Treasurer's Cash Pool (TCP). At the end of June 2022, the State Plan portion was $746.6 million prior to other annual contributions and PL 2023, c. 412 and c. 643 redirecting BSF earnings to the balance.

This shows the impact of redirecting the BSF earnings. Along with the annual actuarial considerations, with $44.2 million applied from BSF earnings, we have recognized a reduction in the UAL balance of more than $450 million, or 60%, based upon earnings to date and future projected earnings over the next decade. Sending money to this long-term obligation means that money will work for us over time, lowering the cash need. Comparatively, dollars for school construction and LMF will be dollar for dollar.

The OPEB-Teachers UAL liability to the state is further increased when the cost share between the state and teachers is adjusted, as it was in PL 2023, c. 412, Part OOOOO with an increase in the state share rate from 55% to 60%.[1] When the OPEB-SEP UAL is liquidated, the intent is to change statute such that these earnings would next be applied to the OPEB-Teachers Trust.

It is not possible to liquidate this $1.2 billion liability by 2037 without some mechanism. Prior year actuarial valuations projected potential increased contributions of $21- $54 million per year between now and 2037. Without the BSF earnings transfer the total liability would likely have increased. It is also highly likely that the turmoil we are seeing in the insurance market will result in an increase in this liability.

I won't read all the below, but as additional information I've included details, including excerpts directly from the Annual Comprehensive Financial Report (as of June 30, 2024), related to these liabilities. My point is that this is a real and significant obligation of the state, one that affects retired teachers, state workers, and first responders.

> *There are three plans: state government, teachers, and first responders. All impact the General Fund, either through the employer-paid portion of health insurance premiums for state workers or through All Other appropriations for teachers and first responders. Managing the state retiree trust is the responsibility of state government, with the trustees of the plan being the Treasurer and the State Controller. The other two plans do not involve state government employees/retirees nor are the plans' trustees the Treasurer and the State Controller.*
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> *The trusts were created to comply with GASB standards regarding OPEB plans a decade ago. Initially, one trust was created to address both State and Teacher Plans, under the standard at that time. Subsequently, GASB issued new guidance, which clarified that the trusts for all three State, Teacher, and First Responder Trusts needed to be separated in our case. (Another case to show that they are not the same.) There are now separate trustees for the State and Teacher OPEB Trusts. The first responder plan has a separately managed investment trust and will eventually have the same trustees as the Teacher OPEB.*

All of the plans have large UAL balances that, per statute, must be retired by 2037. (This is different from the Retirement System UAL that is covered by the Constitution.) These balances impact the General Fund, other funds paying state government workers payroll, and the premium costs of the retiree plans.

The UAL balances as of June 30, 2024 are:

- *$292 million – state plan*
- *$857 million – teacher plan*
- *$29 million – first responders plan (offset in part by a $24 million investment trust account)*

<u>From the Annual Comprehensive Financial Report as of June 30, 2024</u>:

Actuarial assumptions for State Health Insurance plans. All plans use the same basic assumptions including: the entry age normal actuarial cost method, inflation based on 2.75 percent, and a 5-year smoothed market asset valuation; and an investment interest rate and discount rate of 6.5 percent. Salary increases mirror the inflation rate plus a merit component. Plans based their mortality assumptions using the 2010 Public Plan General Benefits-Weighted Healthy Retiree Mortality Table, for males and females, projected generationally using the RPEC_2020 model adjusted for experience. The experience study used is the one from July 1, 2015 to June 30, 2020. The unfunded actuarial liability is being amortized as a level percentage of payroll over a 30-year period on a closed basis.

<u>State Health Insurance</u> The valuation date is June 30, 2024. The participation rate for future retirees is 95 percent of active participants currently enrolled. Experience losses (gains) are amortized over a 10-year fixed period. Assumption changes and plan changes are amortized over a period to June 30, 2037. The unfunded liability will be fully recognized by June 30, 2037. The initial medical trend rate started at 7.09 percent. The ultimate medical trend rate of 4.19 percent is used at 2075. The State actively manages premium increases within the statutory cap, so healthcare cost increases are limited to no more than inflation plus 3 percent in any year.

<u>Teacher Health Insurance</u> The valuation date is 2024 and establishment of a funded Irrevocable OPEB Trust was June 30, 2023. Prior to that date the State funded the plan on a pay-as-you-go basis. 93.33 percent of all Teachers are assumed to be eligible to receive a State contribution at retirement. 75 percent of active participants currently with coverage continue coverage at retirement. One third of active participants who have currently waived coverage elect coverage at retirement. The initial medical trend rate was 7.09 percent. The ultimate medical trend rate of 4.19 percent is used at 2075. Assumption changes and plan changes are amortized over a period to June 30, 2037. The unfunded liability will be fully recognized by June 30, 2037.

<u>Benefits of funding the UAL through contributions to the OPEB trusts</u>:

- Contributions are considered assets on financial statements
- Assets in the trust can be diversified for a potentially greater rate of return
- Actively addressing future obligations can favorably impact credit ratings
- Can help hedge against health care inflation, longer life expectancies for retirees and the "baby boom" retirement surge
- Funds put into an OPEB Trust are dedicated for future OPEB costs and are protected from diversion for other uses
- Funding now means that future taxpayers/employers will not bear a disproportionate burden of costs
- Smaller contributions now will be compounded, making a bigger impact on the UAL, avoiding the need for larger contributions later

Interest earnings are not a consistent source of revenue:

As a reminder of how this distribution fundamentally works, the BSF isn't separately invested but rather the BSF is a component of the overall Treasurer's Cash Pool (TCP). It isn't that the BSF balance of $1 billion is directly invested to earn interest; rather, it is that a pro-rata share of total TCP earnings is distributed to the BSF.

Through FY26, on average, investment earnings related to BSF were approximately $3.7 million per month. Under this proposal, instead of the full amount going to help liquidate one of the state's many obligations, it would be split such that less than $1 million would be going to the OPEB, less than $1 million to LMF, and approximately $1.8 million to School Construction. However, it is important to note, this dollar amount will likely decrease.

First, rates of return fluctuate. The TCP is currently earning record high rates of return as a result of rates secured in prior years. As those investments mature, as we are seeing in the market, they will likely be reinvested at lower interest rates.

Second, the overall balance of the TCP is declining due to reductions in the other balances that comprise the TCP. A significant example is the COVID-19 pandemic relief funds distributed through our Maine Jobs Act. This fund was nearly $1 billion to start; it is now approximately $261 million; and all of the funds must be spent no later than December 2026. Other examples are one-time OSR accounts – PFAS remediation, state building capital improvements, disaster recovery, home resiliency, infrastructure adaptation – that will be spent down. The reduced principle will yield lower returns.

To summarize, the proposed reallocation will short real progress being made toward this OPEB retired teachers, state employees and first responders health insurance liability that will have to be made up with increased General Fund contributions, increased premiums, and health benefits adjustments.

This concludes my testimony, thank you.