WS #3

CITY OF
HAYWARD
HEART OF THE BAY

DATE: March 25, 2008

TO: Mayor and City Council

FROM: Director of Finance and Internal Services

SUBJECT: Overview of Financial Reporting Requirements for Postemployment Benefits Plans other than Pensions – Governmental Accounting Standards Boards Statements No. 43 & 45; and the Results of the Actuarial Study for the OPEB Retiree Medical Benefits.

RECOMMENDATION

That the Council reads and comments on this report.

BACKGROUND

The purpose of this report is to provide the Council with:

1) An overview of the implementation requirements of Governmental Accounting Standards Board's (GASB) Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pensions,*[1] and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, and
2) To present the Council with the results of the actuarial study, related to the City-provided retiree medical benefits.

These new GASB Statements are similar to previous GASB guidance for pensions (GASB Statements 25 and 27). In addition to pensions, governments offer other postemployment benefits (OPEB), such as healthcare. The basic premise of the two statements, 43 and 45, is to measure and report the long-term liability exposure of non-pension post employment benefits, with the idea that these benefits are a form of employee compensation that should be recognized as an expense as the employee earns them, rather than waiting until the employee retires and his or her medical premiums are paid.

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GASB Statement 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans* addresses the financial statement requirements for OPEB held in a third party trust fund. The trust fund must disclose the funding ratio of the Plan – i.e. the ratio of the assets to the liabilities of the Plan. The trust fund could be on the financial report of the plan sponsor, employer, PERS, or other third party. Currently, GASB Statement No. 43 does not apply to the City, since the City does not have a trust fund for OPEB.

An employee is eligible for lifetime medical benefits if all the following criteria are met:

- The employee is a member of the City's bargaining unit that has negotiated this benefit; and the employee has 5 or 10 years of service with the City of Hayward, depending on the unit.
- Employee is vested in the CalPERS system (five years combined service in CalPERS agencies), and
- Employee retires from the City of Hayward within 120 days of the effective date of separation from employment with the City of Hayward.
- In addition, the survivor of the retired employee who qualifies to receive this benefit is also entitled to receive the medical benefit provided he or she has been designated to receive a survivor's pension benefit from CalPERS and is enrolled in one of the City's medical plans.

Summary of Actuarial Results - The City contracted with EFI Actuaries for an actuarial study based on FY 2007 data. This actuarial study provides a baseline to establish the ARC. This actuarial study is provided for your review at Attachment A. Representatives from EFI Actuaries will be presenting the actuarial results at the work session. Below is a summary of the City's liabilities and annual required contribution (ARC):

(in millions)	Full Pre-Funding	Pay As You Go
Discount rate	7.75%	4.50%
Fully projected liability	$ 48.7	$ 91.9
Unfunded accrued liability (UAL)	$ 42.0	$ 70.8
Normal cost (% of pay)	1.39%	3.49%
Amortization of UAL (% of payroll)	5.33%	6.55%
Total Cost (ARC as a % of payroll)	6.72%	10.04%
Total Cost (ARC) for FY 2008	$ 4.3	$ 6.5
Actual funding policy contribution Amount (FY 2008)	$ 4.3	$ 1.7

Implementation Options – Now that the retiree medical benefit liability has been determined, the City must decide how best to manage it, taking into account multiple factors such as the size of the liability; the resources available to fund it; the impact on the City's budget of pre-funding the benefits; legal issues involved in changing any benefits to reduce the liability; whether to establish a trust fund; the need to continue offering competitive benefit packages to attract and retain qualified staff; and the potential impact of funding the plan on bond ratings. At a minimum, rating agencies will look for a well-thought-out plan for addressing the long-term liability under the new rules. Although GASB 45 requires public entities to account for – but not necessarily prepay – the unfunded liability, the financial community will expect jurisdictions to proactively address the liability via some form of funding plan. Addressing these future funding issues is consistent with Council's Fiscal Stability Initiative.

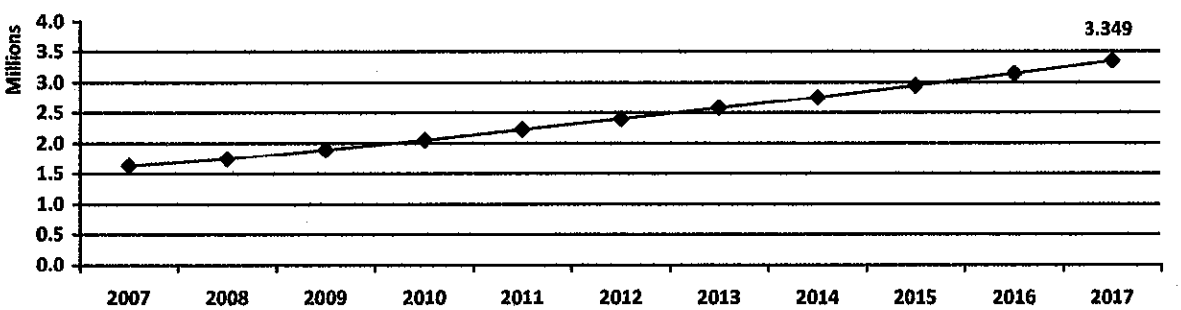
Establishing a trust is one funding plan option for fully or partially funding the liability. Creating a trust means that plan assets are dedicated to providing benefits to retirees in accordance with the terms of the plan and are legally protected. If the City chooses to establish a trust, the following must be considered:

- An irrevocable transfer of assets to a trust means the employer loses access to those funds permanently or until the plan is terminated.
- Plan assets in a trust lower the ARC, thereby lowering the OPEP expenses that must be reported on the City's financial statements.
- Using a trust allows different investment options such as investment in equities and longer-term maturities, possibly lowering the annual cash contribution from the City, since interest earnings may be greater.
- A separate audit may be required.

Another option to consider as a way to fund the City's obligation is to create an Internal Service Benefits Fund and deposit a percentage of payroll into this fund each pay period. The City will then begin to accumulate plan assets, but the funds will stay within the control of the City until the City reaches a level of financial stability that a trust can be considered. While this option allows the City to begin funding the liability, accumulation of these funds will not reduce the City's OPEB liability unless they are transferred to an irrevocable trust that prohibits the use of funds for any other purpose.

FISCAL IMPACT

The City contributed approximately $1.6 million toward retiree medical benefits in FY 2007. The City's current funding policy is pay-as-you-go. Per the actuarial study, these expenses are expected to increase 7-8% annually over the next 10 years. The majority of these costs are currently funded by the General Fund.



The City is likely to save money in the long term if a prefunding policy is implemented. This could be achieved by setting aside a percentage of pay into a special fund or irrevocable trust fund with each payroll. Monies placed in a trust fund will generally accumulate interest at a higher rate than General Fund Assets and reduce the amount required by the General Fund.

However, the City's current fiscal situation does not allow for prefunding of these benefits. Therefore, staff recommends that the City plan to establish an irrevocable trust as soon as fiscally possible to take advantage of compounding higher interest returns, which will lower the overall cost to the City. Staff's goal is to include some level of prefunding in future 10-year financial plans. We will also need to work with our various employee groups in the future to address this long-term liability.

NEXT STEPS

The Budget and Finance Committee will discuss possible future funding options for retiree medical benefits at their next meeting. Staff has provided an article at Attachment B that explains the OPEB liability in detail and discusses various funding options.

Recommended by:

Debra C. Auker, Director of Finance and Internal Services

and

Holly Brock-Cohn, Human Resources Director

Approved by:

Greg Jones, City Manager

Attachments: Attachment A – Actuarial Valuation Report
Attachment B – Funding of OPEB Liabilities article

Attachment A

City of Hayward

Actuarial Valuation of Retiree Healthcare Benefits

as of January 1, 2007

October 4, 2007

EFI* Actuaries • EFI Asset/Liability Management Services, Inc.
The nation's leader in plan-specific, interactive asset allocation optimization counseling
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*Ed Friend, Inc.

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EFI

Introduction and Purpose

EFI Actuaries, under contract with the City of Hayward (the City), performed an actuarial valuation of the retiree healthcare benefits as of January 1, 2007. This report contains the results of the valuation. The purposes of this Report are:

- To compute the annual City contribution required to fund the retiree healthcare benefits (the Plan) on an actuarial basis, and under various funding scenarios.
- To discuss items which are required for disclosure under Statements No. 43 and 45 of the Governmental Accounting Standards Board (GASB).
- To estimate benefit payments over the next 30 years, based on current plan provisions.

This actuarial valuation incorporates methodologies which are required under GASB Statement No. 45 (GASB 45) to disclose the liabilities and costs associated with post-retirement medical and other non-pension benefit plans.

Executive Summary

Plan Cost

A funding policy has not yet been adopted by the City. Assuming pay-as-you-go funding continues, the actuarial cost as of January 1, 2007 would be 10.04%, measured as a percentage of payroll. Projecting pay to Fiscal Year 2008 (July 1, 2007 through June 30, 2008), the corresponding dollar amount of this cost is $6,471,992. The expected benefit payments (nominal premiums) for Fiscal Year 2008 are estimated to total $1,685,658 (2.62% of projected payroll).

Summary of Liabilities and Annual Required Contribution (ARC)

($ millions)	Full Pre-Funding	Pay As You Go
Discount Rate	7.75%	4.50%
Fully Projected Liability	$ 48.7	$ 91.9
Entry Age Accrued Liability	42.0	70.8
Assets	0	0
Unfunded Accrued Liability	42.0	70.8
Normal Cost (% of pay)	1.39%	3.49%
Amortization of UAL (% of pay)	5.33%	6.55%
Total Cost (ARC as a % of pay)	6.72%	10.04%
Total Cost (ARC) for FY 2008	$ 4.3	$ 6.5
Actual Funding Policy Contribution Amount (FY 2008)	4.3	1.7

Summary of Liabilities and Costs by Employee Category (Continued Pay As You Go)

($ millions)	Miscellaneous	Firefighter	Police	Total
Entry Age Accrued Liability	$ 23.6	$ 9.9	$ 37.2	$ 70.8
Normal Cost (% of pay)	2.26%	1.63%	6.94%	3.49%
Amortization of UAL (% of pay)	4.33%	4.45%	11.92%	6.55%
Total Cost (ARC as a % of pay)	6.60%	6.09%	18.86%	10.04%
Total Cost (ARC) for FY 2008	$ 2.2	$ 0.8	$ 3.5	$ 6.5
Expected Benefit Payments for FY 2008	0.7	0.4	0.6	1.7

Results in these tables are based on the current pay-as-you-go funding arrangement, and corresponding discount rate of 4.5%, which represents the expected return on general assets for the City. An alternate

cost calculation was also done under a full funding policy, assuming the City will contribute the full amount of the Annual Required Cost (ARC) to the California Employers' Retiree Benefit Trust (CERBT). The cost under this scenario is shown in Section 1.

The Entry Age Normal actuarial cost method has been used to determine the liabilities and costs in all cases, with a 30-year level dollar amortization of the unfunded accrued liability (UAL). There are other available methods under GASB 45; however, the Entry Age Normal method is required for pre-funding through the CERBT.

Community Rating

The explicit costs of the City's OPEB (Other Post-Employment Benefits) Plan are the healthcare premiums paid to CalPERS or to the retired members and their surviving beneficiaries by the City. An additional implicit cost is associated with plans in which the premium rates charged by an insurer are determined based on the combined demographics of the active and retired populations. If the pre-Medicare retiree group were rated separately, the rates actually charged to the retirees would be higher than the rates currently charged. This is due to the higher average age – and associated higher average medical costs – of this retired group compared to the combined population.

The City provides coverage under the Public Employees' Medical and Hospital Care Act (PEMHCA) through CalPERS. This is a community rated plan as defined in GASB Statement 45. This means that the same premiums would apply for plan participants regardless of the presence or number of active employees in the Plan. The significance of this is that there is *no implicit subsidy* (as described above) associated with providing healthcare benefits to pre-Medicare retirees.

Funding Strategy Implications

To demonstrate the effects of pre-funding benefits, we have determined the City cost for Fiscal Year 2008 based on two scenarios:

1. Full pre-funding of benefits – This implies that the City will consistently contribute an amount equal to the Annual Required Contribution (ARC) as defined by GASB 45.

2. Continuing pay-as-you-go funding – This entails no intended pre-funding, and that all future benefits will be paid from the City's general assets.

It is also possible to implement a funding policy that involves contributing a portion of the full ARC.

CalPERS has set up a fund to allow employers to contribute for pre-funding of retiree healthcare benefits. If the City intends to pre-fund, this is one available option. CalPERS has published a set of OPEB Assumption Model guidelines pertaining to employers who use this funding option. The guidelines place restrictions on actuarial cost method, discount rate, asset valuation, medical inflation, and demographic assumptions. The assumptions used for this valuation are in compliance with the guidelines.

Should a fund be set up independently, GASB Statement 43 has particular requirements pertaining to the legal structure of the trust fund when determining whether assets can be considered to be accumulated for the purposes of pre-funding the OPEB benefits, specifically:

- Contributions to the plan are irrevocable
- Plan assets are dedicated to providing benefits to their retirees and their beneficiaries in accordance with the terms of the plan
- Plan assets are legally protected from creditors of the employer or plan administrator

The key difference between the funding strategies described above is in the selection of the discount rate (i.e. return assumption) used to determine liabilities and costs. As required by GASB 45, the return assumption must correspond with the assets used to support the benefits. For a plan with a full-funding policy, the expected return on plan assets may be used. For an unfunded plan (i.e. pay-as-you-go), the City's expected rate of return on general funds will be required. For a plan with a partial-funding policy, a blended rate will be required whereby the expected return can be a weighted average of the two rates.

The discount rate and assumed future medical inflation are key economic assumptions, and as shown in this report have a substantial impact on the determination of liabilities and costs. A lower discount rate leads to a higher present value of future benefits, and subsequently higher calculated liabilities and actuarial costs. A higher assumed medical inflation leads to higher costs. This impact is somewhat mitigated for certain employees due to defined City maximum contributions.

The calculations of Plan liabilities and costs in this Report have been developed in accordance with generally accepted actuarial methods and procedures.

Graham A. Schmidt, ASA

Gregory M. Stump, FSA

EFI

Section 1

Actuarial Computations (GASB Liabilities)

Development of Actuarial Cost: Pre-Funding Scenario

	Miscellaneous	Firefighters	Police Officers	Total
Fully Projected Liability				
Active	8,662,197	2,848,151	13,420,752	24,931,100
Inactive	8,200,790	4,221,685	11,389,435	23,811,910
Total	16,862,987	7,069,836	24,810,187	48,743,010
EAN Accrued Liability				
Active	6,723,947	2,137,809	9,333,881	18,195,637
Inactive	8,200,790	4,221,685	11,389,435	23,811,910
Total	14,924,737	6,359,494	20,723,316	42,007,547
Actuarial Value of Assets	0	0	0	0
Unfunded Accrued Liability (UAL)	14,924,737	6,359,494	20,723,316	42,007,547
Normal Cost	322,421	83,051	473,870	879,342
Amortization of UAL (30 years, level $)	1,201,468	511,951	1,668,264	3,381,683
Normal Cost (% Pay)	1.01%	0.64%	2.58%	1.39%
Amortization Cost (% Pay)	3.75%	3.93%	9.09%	5.33%
Total Cost (% Pay)	**4.76%**	**4.57%**	**11.67%**	**6.72%**
Projected Payroll (FY 2008)	32,554,020	13,252,058	18,648,792	64,454,870
Total Cost for Fiscal 2008	**$ 1,548,454**	**$ 604,593**	**$ 2,176,665**	**$ 4,329,713**

Development of Actuarial Cost: Pay-As-You-Go Scenario

	Miscellaneous	Firefighters	Police Officers	Total
Fully Projected Liability				
Active	17,769,908	6,205,180	32,478,765	56,453,853
Inactive	11,421,490	5,932,262	18,126,139	35,479,890
Total	29,191,398	12,137,442	50,604,904	91,933,743
EAN Accrued Liability				
Active	12,209,362	3,951,505	19,116,502	35,277,370
Inactive	11,421,490	5,932,262	18,126,139	35,479,890
Total	23,630,852	9,883,767	37,242,641	70,757,260
Actuarial Value of Assets	0	0	0	0
Unfunded Accrued Liability (UAL)	23,630,852	9,883,767	37,242,641	70,757,260
Normal Cost	725,163	213,142	1,274,174	2,212,479
Amortization of UAL (30 years, level $)	1,388,263	580,650	2,187,927	4,156,840
Normal Cost (% Pay)	2.26%	1.63%	6.94%	3.49%
Amortization Cost (% Pay)	4.34%	4.46%	11.92%	6.55%
Total Cost (% Pay)	**6.60%**	**6.09%**	**18.86%**	**10.04%**
Projected Payroll (FY 2008)	32,554,020	13,252,058	18,648,792	64,454,870
Total Cost for Fiscal 2008	**$ 2,147,494**	**$ 806,589**	**$ 3,517,909**	**$ 6,471,992**

Timing and Implementation of GASB 43 and 45

GASB Statement 43 governs the required disclosures for an established OPEB *plan*. This statement would become applicable if the City establishes an OPEB fund outside of CalPERS that is considered to satisfy the requirements of the Statement. Implementation of disclosure under GASB 43 is required for the first fiscal year beginning after December 15, 2005 for the City (Fiscal Year 2007).

GASB Statement 45 governs the accounting for OPEB costs on the financial statements of the *employer*. The City must implement GASB 45 for Fiscal Year 2008. Early implementation is optional and is encouraged by GASB.

GASB 45 specifies that the percentage of payroll used in determining the ARC for a given year may be based on an actuarial valuation up to 24 months in advance of the beginning of that fiscal year. Therefore, the percentage of payroll cost determined from the January 1, 2007 actuarial OPEB valuation can be used to derive the Fiscal Year 2008 or the Fiscal Year 2009 ARC.

Sample GASB 43 and 45 Disclosure Statements

The tables below present sample exhibits required under the two financing approaches described earlier: fully pre-funded and pay-as-you-go. In the pay-as-you-go scenario, the employer contribution amount is set equal to the net employer retiree cost for the current year. Under the pre-funded scenario, we assume that the City will contribute an amount equal to the computed ARC to that trust.

In both cases, we have determined the Fiscal Year 2008 ARC by multiplying the percentage of payroll cost by the projected payroll. All are based on the Entry Age Normal actuarial cost method. The following table shows the components of the City's annual OPEB cost for the year based on projected payroll, the amount contributed, and changes in the net OPEB obligation under all scenarios. Once a funding policy is established, only one of the scenarios will need to be shown.

Annual OPEB Cost, Contribution, and Changes in Net OPEB Obligation For the Fiscal Year Ending June 30, 2008

($ thousands)	Fully Pre-Funded (7.75% discount rate)	Pay-As-You-Go (4.5% discount rate)
Annual Required Contribution	$ 4,330	$ 6,472
Interest on Net OPEB Obligation	0	0
Adjustment to Annual Required Contribution	0	0
Annual OPEB cost (expense)	$ 4,330	$ 6,472
Contributions Made	4,330	1,686
Increase in Net OPEB Obligation	$ 0	$ 4,786
Net OPEB Obligation – Beginning of Year	0	0
Net OPEB Obligation – End of Year	$ 0	$ 4,786

Funded Status of the Plan as of January 1, 2007

($ thousands)	Fully Pre-Funded (7.75% discount rate)	Pay-As-You-Go (4.5% discount rate)
Actuarial Accrued Liability (AAL)	$ 42,008	$70,757
Actuarial Value of Plan Assets	$ 0	$ 0
Unfunded Actuarial Accrued Liability (UAAL)	$ 42,008	$ 70,757
Funded ratio (Actuarial Value of Plan Assets / AAL)	0.0%	0.0%
Covered Payroll (Active Plan Members)	$ 63,432	$ 63,432
UAAL as a Percentage of Covered Payroll	66.2%	111.5%

A three-year schedule of the ARC, contributions, net obligation, and funding status is also required within the disclosure statements We have not shown this schedule as the historical information does not yet exist to produce it.

Projection of Benefits and Contributions

The following projections are based on the current covered population; any benefits expected to be paid to future new entrants are not included. All assumptions are the same as used for the actuarial valuation as of January 1, 2007.

Calendar Year	Expected Benefit Payments
2007	1,627,000
2008	1,744,000
2009	1,894,000
2010	2,053,000
2011	2,225,000
2012	2,398,000
2013	2,577,000
2014	2,751,000
2015	2,947,000
2016	3,143,000
2017	3,349,000
2018	3,553,000
2019	3,801,000
2020	4,034,000
2021	4,262,000
2022	4,481,000
2023	4,703,000
2024	4,937,000
2025	5,159,000
2026	5,379,000
2027	5,601,000
2028	5,834,000
2029	6,053,000
2030	6,245,000
2031	6,428,000
2032	6,613,000
2033	6,768,000
2034	6,908,000
2035	7,034,000
2036	7,141,000

Section 2

Summary of Plan Provisions

Benefit Eligibility

An employee is eligible for lifetime medical benefits under the Plan, if all criteria listed below are met:

1a. The employee is a member of the HAME, Police, Police Management or Fire bargaining units, and the employee has ten or more years of service with the City of Hayward; or

1b. The employee is a member of one of the other bargaining units for the City of Hayward, and the employee has five or more years of service with the City of Hayward; and

2. The employee is eligible for retirement as defined under the CalPERS retirement system; and
3. The employee retires within 120 days of the effective date of separation from employment with the City of Hayward; and
4. The employee is enrolled in a medical plan offered by the City of Hayward.

In addition, the survivor of a retired employee who qualifies to receive this benefit is also entitled to receive the medical benefit provided he or she has been designated to receive a survivor's pension benefit from CalPERS and is enrolled in one of the City's medical plans.

Benefit Amount

Eligible retirees receive a City paid medical benefit in an amount shown in the table below, paid as a direct payment to the CalPERS medical insurance plan and/or as a supplemental payment to the retiree, subject to a maximum amount equal to the member's actual premium.

Group	Maximum Monthly Contribution
Clerical	$ 226.01
Maintenance	226.01
Confidential	226.01
Professional & Technical	226.01
HAME	274.72
Unrepresented	237.31
Police	431.17
Police Mgmt	274.72
Fire	249.18
Fire Mgmt	261.31
Elected	237.31

The benefit amount for the Police bargaining unit is set to be equal to the Kaiser North single party rate ($431.17 per month for 2007). The benefit amount for all other bargaining units is determined under the negotiating process.

Funding

The cost of the benefits provided by the Plan is currently being paid by the City on a pay-as-you-go basis. The long-term strategy for funding the benefits provided under the Plan is currently being evaluated.

Section 3

Summary of Participant Data

Participant Data

Data on active and inactive employees and their beneficiaries as of January 1, 2007 was supplied by the City on electronic media. Participant data was reviewed for reasonableness and consistency but was neither verified nor audited.

A summary of data as of January 1, 2007 is shown below.

Active Participants	
Number of Participants	814
Average Age	43.9
Average Service	11.4
Average Projected Pay	$77,927
Number Currently Retirement Eligible	209

Inactive Participants	Total
Number of Retired Participants	394
Average Age	68.2
Number of Disabled Participants	132
Average Age	60.3
Number of Beneficiaries of Deceased Participants	49
Average Age	73.1
Total Number Covered	466

The following table is a summary of the current healthcare coverage for the above participants.

Medical Plan Name	Number of Active Participants	Number of Pre-Medicare Inactive Participants	Number of Medicare Eligible Inactive Participants
Blue Shield			
Single Coverage	38	11	7
Dual Coverage	41	8	17
Family Coverage	167	17	4
Kaiser			
Single Coverage	71	28	62
Dual Coverage	66	23	12
Family Coverage	232	49	62
Pers Care			
Single Coverage	18	3	38
Dual Coverage	13	2	25
Family Coverage	42	1	1
Pers Choice			
Single Coverage	5	9	14
Dual Coverage	4	13	18
Family Coverage	6	15	1
PORAC			
Single Coverage	4	4	7
Dual Coverage	2	1	2
Family Coverage	6	12	0
Other	0	0	0
Waived Coverage	99	0	0

Section 4

Actuarial Methods and Assumptions

Actuarial Methods and Glossary of Terms

The annual actuarial contribution to pay for the medical benefits provided to retired employees of the City is computed under the Entry Age Normal Actuarial Cost Method.

Specific operation of this Cost Method is as follows:

Normal Cost

- The liability for all future healthcare benefits payable by the City to current and future retired employees is computed. This is called the *Fully Projected Liability*.
- Entry age is established based on the service provided in the data from the City.
- A portion of the *Fully Projected Liability* is assigned for each participant based on a comparison of total career earnings to the assumed past earnings. The sum of these portions is called the *Actuarial Accrued Liability*.
- The excess of the total *Fully Projected Liability* over the *Actuarial Accrued Liability* is divided by the present value of future pay to determine the *Normal Cost* as a percentage of pay. The percentage for each individual is multiplied by their respective pay. The sum of these is the City *Normal Cost*.
- The City *Normal Cost* is divided by the total payroll to determine *Normal Cost* as a percentage of payroll.

Amortization Cost

- The actuarial value of the assets on hand to pay future benefits is subtracted from the *Actuarial Accrued Liability*, producing the *Unfunded Actuarial Accrued Liability*.
- The *Unfunded Actuarial Accrued Liability* determined from this valuation is amortized as a level dollar amount over a closed period of 30 years. The payment for a given year is expressed as a percentage of projected active member payroll for that year.
- Amortizations of future gains and losses can be tracked individually and amortized over different periods.

The sum of the *Normal Cost* and the *Amortization Cost* is the total City contribution percentage.

The City's actuarial cost is determined by multiplying the active payroll by City contribution percentage.

Actuarial Value of Plan Assets

There are currently no assets set aside to pay for retiree healthcare benefits. Market Value = Actuarial Value = $0.

Actuarial Assumptions

The assumptions used for this valuation are in accordance with the CalPERS "OPEB Assumption Model", which describes guidelines to be used for retiree healthcare valuations for plans intending to pre-fund benefits through California Employers' Retiree Benefit Trust (CERBT).

Valuation Date	All assets and liabilities are computed as of January 1, 2007.
Rate of Return	The annual rate of return on assets used to pay for benefits is assumed to be 4.5% (assumed rate of return on general assets). The rate of return for assets in a trust is assumed to be 7.75%.
Inflation	The cost of living as measured by the Consumer Price Index (CPI) is assumed to increase at the rate of 3.00% per year.
Salary increases	Salaries are assumed to increase annually at 3.25%
Retired Employee Mortality	Rates of mortality for retired employees and their beneficiaries are based on the current CalPERS age-based assumptions. Representative rates are as follows:

Age	Male	Female
50	0.245%	0.136%
55	0.429%	0.253%
60	0.721%	0.442%
65	1.302%	0.795%
70	2.135%	1.276%
75	3.716%	2.156%
80	6.256%	3.883%
85	10.195%	7.219%
90	17.379%	12.592%
95	25.917%	21.773%
100	34.724%	32.036%

Disabled Employee Mortality

Rates of mortality for retired employees and their beneficiaries are based on the current CalPERS age-based assumptions. Representative rates are as follows:

Age	Male	Female
50	1.459%	1.129%
55	2.115%	1.481%
60	2.870%	1.884%
65	3.617%	2.356%
70	4.673%	3.020%
75	6.552%	4.298%
80	9.481%	6.514%
85	14.041%	10.269%
90	20.793%	16.189%
95	30.792%	25.522%
100	45.599%	40.236%

Active Employee Mortality

Rates of non-duty related active member mortality are based on the current CalPERS age-based assumptions. Representative mortality rates for active members are as follows:

Age	Male	Female
20	0.019%	0.009%
30	0.038%	0.021%
40	0.077%	0.046%
50	0.156%	0.102%
55	0.221%	0.151%

In addition, public safety members are also assumed to experience *duty-related* mortality based on the CalPERS assumptions, given by the following representative rates:

Age	Public Safety (Male and Female)
20	0.003%
30	0.010%
40	0.017%
50	0.023%
55	0.027%

Increases in Pay

Assumed pay increases for active employees consist of increases due to inflation (cost of living adjustments) and those due to longevity and

promotion.

Rates of assumed annual rates of future pay increases are based on the current CalPERS current age and service based assumptions. Representative rates of salary increases, including inflation, are as follows (rates are shown based on an Entry Age of 30):

Service	General	Police	Fire
0	12.65%	11.15%	10.75%
1	10.75%	9.55%	9.65%
2	9.35%	8.35%	8.55%
3	8.25%	7.25%	7.75%
4	7.35%	6.35%	7.05%
5	6.75%	5.75%	6.45%
10	4.85%	4.45%	4.85%
15	4.35%	4.15%	4.15%
20	3.95%	3.85%	3.85%
25	3.65%	3.55%	3.55%
30	3.25%	3.25%	3.25%

Service Retirement

Rates of service retirement eligible to retire are the current CalPERS age, and for public safety members, service-based assumptions. For public safety members, the representative rates shown below are based on an employee with 25 years of service at retirement.

Age	General Male	General Female	Police	Fire
50	5.0%	7.0%	12.1%	6.8%
51	2.0%	5.0%	10.7%	9.2%
52	3.0%	5.0%	17.1%	13.8%
53	3.0%	5.0%	19.2%	16.6%
54	4.0%	5.0%	19.7%	20.4%
55	8.0%	9.0%	25.0%	25.2%
56	6.0%	7.0%	19.1%	24.1%
57	7.0%	6.0%	22.3%	20.1%
58	8.0%	10.0%	22.0%	23.5%
59	9.0%	9.0%	22.8%	19.9%
60	16.0%	12.0%	100.0%	100.0%
61	15.0%	10.0%	100.0%	100.0%
62	26.0%	21.0%	100.0%	100.0%
63	22.0%	18.0%	100.0%	100.0%

64	15.0%	13.0%	100.0%	100.0%
65	25.0%	25.0%	100.0%	100.0%
66	14.0%	15.0%	100.0%	100.0%
67	12.0%	14.0%	100.0%	100.0%
68	12.0%	11.0%	100.0%	100.0%
69	9.0%	13.0%	100.0%	100.0%
70+	100.0%	100.0%	100.0%	100.0%

Disability

Representative rates of ordinary disability are as follows:

Age	General Male	General Female	Police	Fire
20	0.01%	0.01%	0.01%	0.01%
25	0.02%	0.02%	0.01%	0.01%
30	0.02%	0.04%	0.02%	0.01%
35	0.08%	0.10%	0.03%	0.01%
40	0.15%	0.16%	0.04%	0.01%
45	0.24%	0.23%	0.05%	0.02%
50	0.37%	0.35%	0.08%	0.05%
55	0.49%	0.41%	0.13%	0.10%
60	0.55%	0.39%	0.20%	0.15%

In addition, public safety members are also assumed to experience *duty-related* disability based on the CalPERS assumptions, given by the following representative rates:

Age	Police	Fire
20	0.06%	0.02%
25	0.28%	0.10%
30	0.56%	0.21%
35	0.84%	0.31%
40	1.12%	0.41%
45	1.40%	0.51%
50	1.67%	0.62%
55+	5.81%	6.01%

Termination

Rates of termination for all employees from causes other than death, disability, and service retirement are based on the current CalPERS current age and service based assumptions. Representative (based on an Entry Age of 30) are as follows:

Service	General	Police	Fire
0	16.22%	12.99%	9.47%
1	14.23%	8.16%	7.39%
2	12.24%	3.48%	5.31%
3	10.25%	3.31%	3.23%
4	8.26%	3.14%	2.90%
5	6.27%	2.97%	2.57%
10	4.35%	2.13%	0.90%

15	3.07%	1.29%	0.79%
20	0.41%	0.22%	0.16%
25	0.09%	0.15%	0.10%

Medical Inflation

Annual increases in retiree healthcare benefits are assumed to be as follows:

Year	Gross Medical (Police)	City Maximum Contribution (All Others)
2007	7.7%	3.5%
2008	12.0%	3.5%
2009	10.5%	3.5%
2010	9.0%	3.5%
2011	8.0%	3.5%
2012	7.0%	3.5%
2013	6.0%	3.5%
2014+	5.0%	3.5%

The medical growth rates are based on an analysis of anticipated growth in healthcare costs in the state of California, as well as known information regarding future changes in rates. The benefit amount for the Police (General) bargaining unit is directly tied to the medical premium; therefore the expected rate of increase in the Police benefit is equal to the assumed increase in the medical premium costs. The expected rate of increase for all other bargaining units is based on the expected growth in the negotiated City maximum contribution.

Election of Coverage

80% of all 90% of all active members (90% for general Police) are assumed to elect medical coverage upon retirement. 65% of these members are assumed to be married and to elect spouse coverage.

Family Composition

Males are assumed to be three years older than their wives.

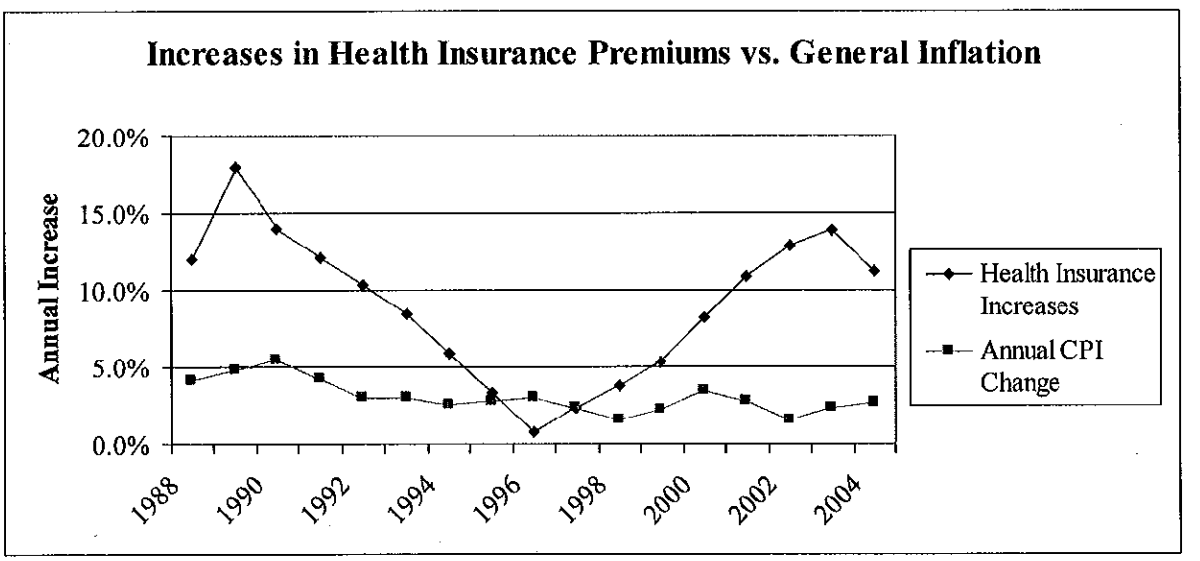
Appendix: Sensitivities to Economic Assumptions

Uncertainties in OPEB Projections: Healthcare Inflation

As can be seen in the discussion above, the decision to pre-fund post-retirement benefits has a large impact on the determination of the OPEB liabilities and costs.

Also, unlike pension plans, which have a relatively predictable pattern of benefits, post-retirement healthcare benefits are much more difficult – if not impossible – to forecast accurately. Pension benefits are based on service and salary, which can be reasonably anticipated. Post-retirement medical benefits are much more variable, as they depend heavily on medical inflation. In fact, healthcare inflation is the most important determinant of the City cost over the long term.

The chart below demonstrates the extreme variability in health insurance premiums since the 1980's.



In order to calculate future medical benefits, it is common to use relatively high expected medical inflation rates for the next few years, which gradually decrease over time. One explanation for the downward trend in medical inflation rates is that if medical inflation is not controlled, then expenditures in the health-related sectors will constitute an unacceptably large portion of the overall national economy. It is not clear yet whether this explanation will prove to be correct.

Even if medical inflation decreases to the level of general inflation, long-term rates of medical premium rate increases may still exceed the general inflation rate. Medical care premiums often increase faster than medical inflation due to the particulars of the medical coverage, such as the leveraging effect of employee cost-sharing (co-pays, deductibles, etc.) on premium rates. For this reason, a long-term medical inflation assumption is frequently set at a level higher than assumed general inflation. The CalPERS OPEB guidelines suggest an ultimate medical inflation between 4% and 6%.

The tables below demonstrate the impact of medical inflation and investment return on Plan costs, showing liabilities and costs under three scenarios each. The baseline scenarios apply the valuation assumptions of a 4.5% return, initial annual medical inflation of 12% and ultimate rate of 5%, and 3.5% increases in employer maximums. The alternate scenarios assume medical costs and employer maximums or investment returns increase at rates 1% higher and 1% lower per year than valuation assumptions. In each case, the Entry Age Normal cost method was used.

Summary of Liabilities and Pay-as-you-go Cost (ARC)
Under Various Medical Inflation Scenarios

($ millions)	Valuation Assumptions	Increased Medical Inflation	Decreased Medical Inflation
Initial Medical Inflation (first two years)	7.66%, 12.0%	8.660%, 13.0%	6.66%, 11.0%
Ultimate Medical Inflation	5.0%	6.0%	4.0%
Increase in Employer Maximum	3.5%	4.5%	2.5%
Unfunded Accrued Liability (UAL)	$ 70.8	$ 86.3	$ 58.8
Normal Cost (% of Pay)	3.49%	4.66%	2.64%
Amortization of UAL (% of Pay)	6.55%	8.00%	5.45%
Total Cost (% of Pay)	**10.04%**	**12.66%**	**8.09%**

Summary of Liabilities and Pay-as-you-go Cost (ARC)
Under Various Investment Return Scenarios (Pay-as-you-go)

($ millions)	Valuation Assumptions	Increased Return	Decreased Return
Assumed Return	4.5%	5.5%	3.5%
Unfunded Accrued Liability (UAL)	$ 70.8	$ 59.4	$85.4
Normal Cost (% of Pay)	3.49%	2.59%	4.76%
Amortization of UAL (% of Pay)	6.55%	6.11%	7.08%
Total Cost (% of Pay)	**10.04%**	**8.70%**	**11.84%**

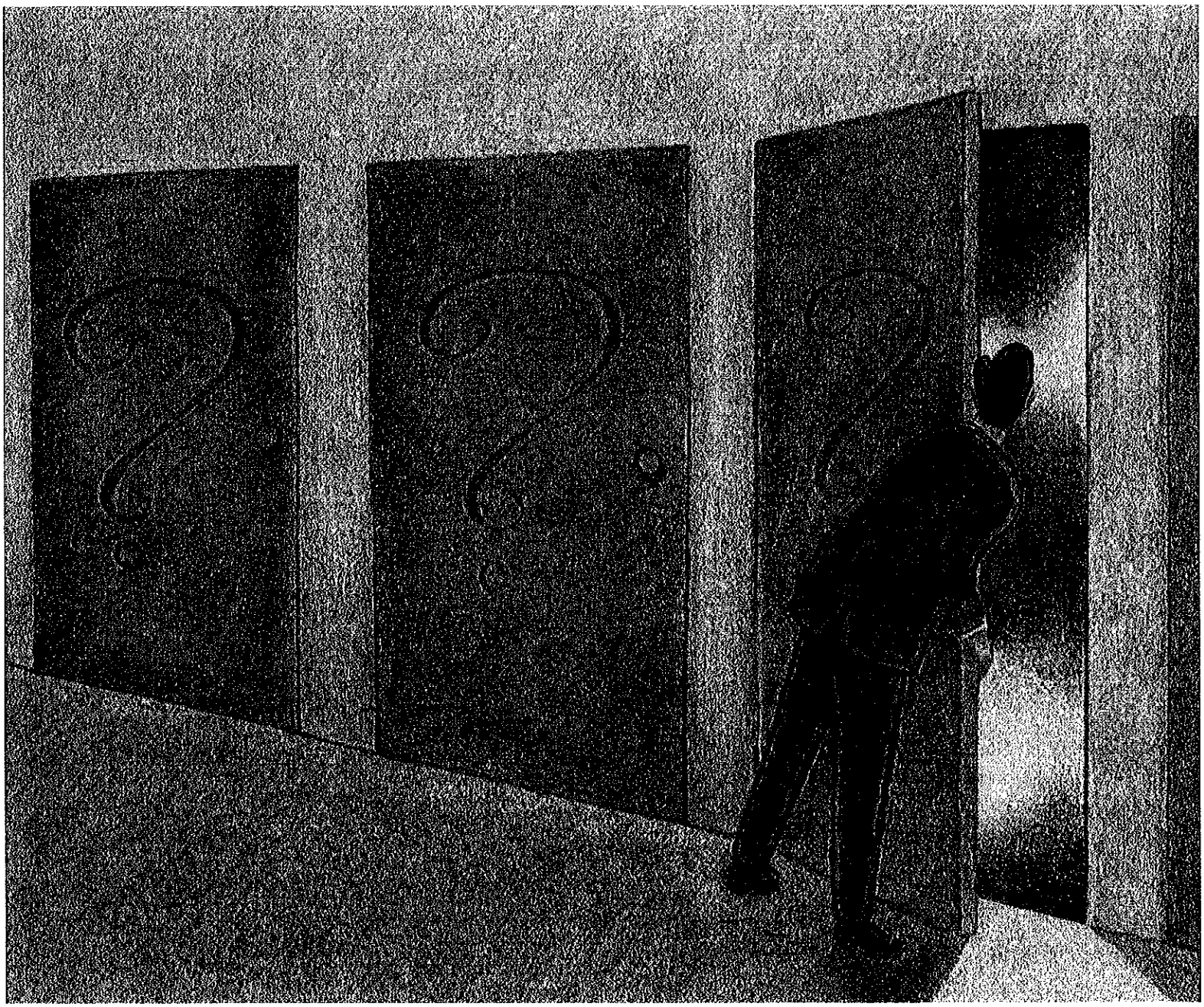
As a point of comparison, a reduction of 1% in the annual earnings on Plan investments may be expected to increase the cost of the Plan to 11.84% of payroll, as shown above. Comparing this to the 12.66% level due to higher medical inflation and employer maximums, Plan costs appear to be more sensitive to changes in the rates of medical inflation and benefit increases than to similar changes in the rate of earnings on assets.

Uncertainties in OPEB Projections: Other Sources

There are other types of risk associated with the determination of post-retirement medical costs that are difficult to quantify, such as political risk. As an example, the Medicare reform legislation that was recently passed will have a great impact on future prescription drug costs, and many employers have not yet decided what approach they will use to take advantage of these benefits.

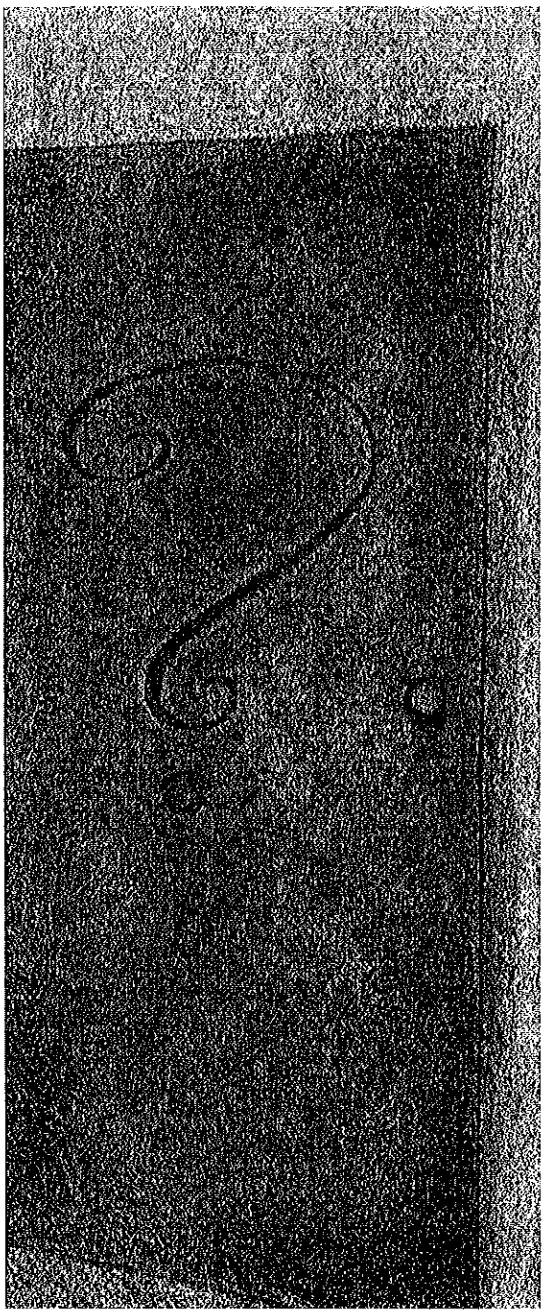
No offsets for the receipt of current of future anticipated Part D subsidies from the Federal government have been included in these calculations, as recent guidance from GASB has taken the position that any Part D subsidies received from the Federal government must be accounted for as a separate transaction, and therefore cannot be used to reduce OPEB expense or future OPEB liabilities. Other examples of future uncertainty are the establishment of a nationalized healthcare program or decreases in the Medicare eligibility age. Each of these would have enormous impacts on valuation liabilities.

Funding OPEB Liabilities



WHAT ARE YOUR OPTIONS?

BY PARRY YOUNG



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The fulfillment of retiree pension and other benefit obligations has become a major concern globally in both the government and private sectors, driven in part by the demographic phenomenon of people living longer. In addition, life style choices have tended to lower the actual retirement age. These two factors have expanded the period during which pension benefits must be paid, resulting in burgeoning liabilities for employers. Adding to the problem has been the rapid increases in costs related to retiree health care. While state and local governments have been struggling to maintain adequate funding for pensions, buffeted not only by demographics but also by investment losses and recent benefit increases, a new challenge has appeared on the horizon in the form of changes in the financial reporting for and funding of other retiree benefit costs.

Last year, the Governmental Accounting Standards Board issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. These other postemployment benefits, known as OPEB, include health care, as well as all other retiree benefits that are not a part of a pension plan. Retiree health care is always considered OPEB. This class of postemployment benefit may also include a variety of options such as life insurance or other non-pension benefits. In essence, the new GASB requirements for OPEB tend to follow the reporting requirements for pension benefits because the benefits are similar in nature and both are a form of deferred compensation.

While OPEB costs have traditionally been accounted for and financed on a pay-as-you-go (PAYGO) basis, they will now be treated for accounting purposes on an accrual basis like pensions. Once a government determines its OPEB liability under the new standard, it will then have to decide how to manage it. Should the employer advance fund its OPEB liability under GASB 45 or continue to use the PAYGO method? If the advance funding choice is made, how will the resultant higher contributions affect the budget? Is the current benefit structure sustainable given the new approach? This article will present an overview of the new OPEB reporting requirements; the implications for employers, including some of the options that may be available for managing this liability; the effects of advance funding the liability; and certain managerial considerations that employers may have to face during the process of measuring their OPEB costs and obligations, and preparing for implementation of GASB 45.

THE NEW OPEB ACCOUNTING RULES

In its introduction to Statement No. 45, the GASB said that OPEB "are part of an exchange of salaries and benefits for employee services rendered." Further, from "an accrual accounting perspective, the cost of OPEB, like the cost of pension benefits, gen-

erally should be associated with the periods in which the exchange occurs, rather than with the periods (often many years later) when benefits are paid or provided." GASB believes that the reporting for the current PAYGO financing practice fails to:

- Recognize the *cost* of benefits in periods when the related services are received by the employer
- Provide information about the *actuarial accrued liabilities* for promised benefits associated with past services and whether and to what extent those benefits have been funded
- Provide information useful in assessing potential demands on the employer's future cash flows.[1]

The intention of GASB 45 is to overcome these deficiencies and provide more relevant and useful reporting. In addition, by requiring the financial reporting of OPEB expense as services are provided, issues related to intergenerational inequities will be addressed.

A simple example of the practical application of the new reporting standard can be found in looking at the OPEB cost structure of a fictitious, new city with a relatively young fire department. The city has promised lifetime health care benefits to the department's members in its labor negotiations. Currently, this retiree benefit costs the city nothing on the PAYGO basis, since there are no retirees. However, as the firefighters age and actually retire and collect health care benefits, suddenly the city will experience a new and growing budget item. Even for an older city, the current PAYGO OPEB costs may only be the tip of the iceberg, as these expenses subsequently mushroom – not only from the increasing number of retirees, but also from accelerating health care-related expenses. GASB 45 will lead governments to present a clearer picture by requiring that governments take into consideration for financial reporting purposes both current and probable future cash flows associated with promised benefits for services received to date.

Basically, the new standard requires that employers using single-employer or agent multiple employer defined benefit OPEB plans measure and disclose the annual OPEB cost on the accrual basis of accounting. This cost is equal to the employer's annual required contribution (ARC) to the plan with some adjustments. The ARC includes the normal cost for the year and an amount to amortize the total unfunded actuarial accrued liability (or funding excess) over a period of up to 30 years. Actuarial valuations are required at least every two years for plans with 200 members or more. Single employers with fewer than 100 members may use a simplified alternative measurement method.

The cumulative difference between the employer's annual OPEB cost and its contributions to the plan is called the net OPEB obligation. If there is a net OPEB obligation at the beginning of the period, the ARC is adjusted for both the interest on that obligation and past under- or over-contributions to get the final amount. The net OPEB obligation is calculated from the implementation of GASB 45 forward (retroactive application of GASB 45 is not required). Contributions may include direct payment of benefits, paid insurance premiums, and assets irrevocably transferred to a dedicated trust.

OPEB information will be included in the different sections of the annual financial report, similar to that for pensions. The government-wide statements will report the net OPEB obligation. The most recent funded status (actuarial value of OPEB assets divided by the actuarial accrued liability) will be found in the notes to the financial statements. Management's discussion and analysis will include any major changes for the year. Trends in actuarial data will be found in the required supplementary information.

IMPLICATIONS FOR STATES AND LOCALITIES

With completion of the GASB 45 actuarial groundwork, the employer will have a clear picture of its OPEB actuarial liability exposure. The question then becomes how to manage this liability. One general difference between pension and OPEB liabilities for state and local governments in the United States is that while most jurisdictions have offered defined benefit pension plans with basically similar terms and historically documented values, there is a wide disparity in the scope of benefits offered as OPEB and, therefore, the starting point for actuarial accrued liabilities will vary widely. Whereas one government may give lifetime health care benefits for retirees and spouses, another may offer little or no coverage. This dichotomy will mean that the actual financial effect of GASB 45 on various governments will be uneven. For example, one government may find that it can manage its benefits with little or no change in plan terms, while another government may conclude that a major overhaul in the retiree benefit structure is needed.

As the employer evaluates its position under the new OPEB reporting requirements, it can then develop a plan to manage its liability under the new rules. For those with minimal OPEB exposure, the accounting and financial effect will be minimal. For those with greater exposure, serious review and planning must be done to address the problem.

Once the actuarially based liability and annual OPEB cost (expense, derived from the ARC) are determined, management may want to decide if it will fund the plan or continue to handle it

on a PAYGO basis. It is important to note that GASB does *not* require funding of OPEB. In most cases the GASB 45 ARC payment will be a multiple of the existing PAYGO amount. Depending on the size of the plan, including the number of employees and the level of benefits in relation to an entity's total budget, advance funding the plan under the new rules may add stress to the budget. On the other hand, continuing to pay only the PAYGO amount will result in a growing unfunded actuarial liability and net OPEB obligation. Before making a final decision on whether or not to fund the plan, management may want to take a step back and look at the entire slate of postemployment benefits to see if there are ways to lower the total liability and, further, the unfunded liability. (Since few OPEB plans have actual assets, usually when we say OPEB liabilities we mean unfunded liabilities.)

SELECTED STRATEGIES TO REDUCE OPEB COSTS

There are several strategies employers can use to manage their OPEB costs in light of the new GASB 45 requirements. Some may opt to reduce their exposure to OPEB liabilities through actual changes to the plan structure. These methods include the following:

Reduce OPEB benefits. An employer may be able to change the number of years for which a retiree is eligible to receive health care coverage; for example, a former lifetime benefit may be changed to end at age 65.

Offer new employees (or new retirees) a lower benefit level. The creation of different tiers of benefit levels has been a tactic used to manage pension benefit liabilities for many years.

Place a cap on employer-provided benefits. This could limit the total exposure to the employer for a variety of different benefits.

Convert a defined benefit plan to a defined contribution plan. A DC plan limits the employer's exposure in terms of the amount of contributions and shifts the risk of benefit fulfillment to the employee (in the DB model the employer has the risk).

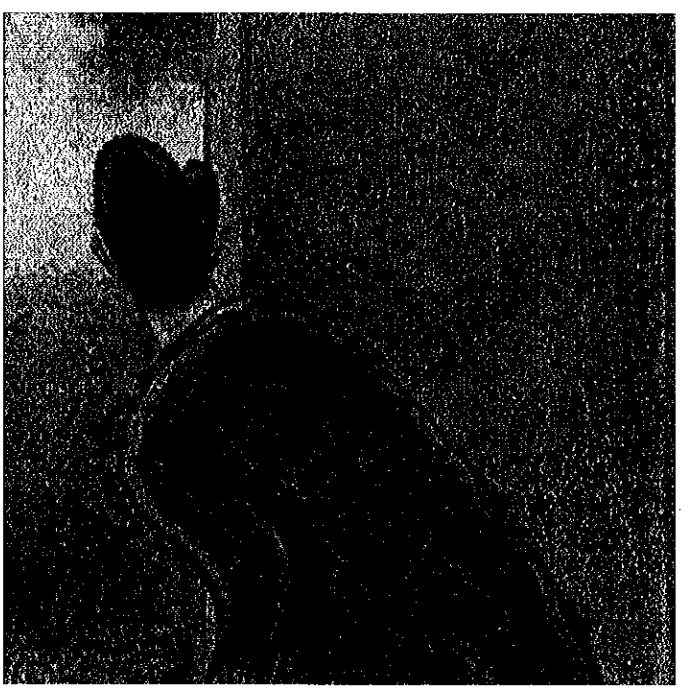
There are also ways for employers to ease the pressure from cash outflows, such as introducing or increasing employee contributions to the plan, or increasing employee co-pays. Of course, the actual implementation of any of these options will present difficult managerial challenges.

ADVANCE FUNDING – WHAT'S IN IT FOR EMPLOYERS?

The advance funding of OPEB presents a vehicle for employers to build an asset base to offset the actuarial accrued liabilities and provide for payment of the benefits as they come due in future years. Contributions to a funded OPEB plan over time should be more stable, if initially higher, than under a PAYGO arrangement, in that PAYGO cash outlays are directly (immediately) affected by the vagaries of volatile health care costs. While advance funding of OPEB will not rein in actual health care costs, the flows into the plan should be more predictable because actuarially funded benefit plans usually attempt to stabilize contribution rates. However, due to the dynamics of the health care industry, actuarially determined contribution rates for OPEB will probably be more susceptible to change than contribution rates for pension benefits.

The growth in real assets through advance funding also will provide greater benefit security for employees/retirees, since progress of funding by tangible investments can be measured and monitored over time. As the asset base builds and the funding ratio increases, a larger share of the revenues into the plan will come from investment income, while the corollary portion from contributions declines. This relationship is part of the design and was the experience in the development of pension trust funds in the U.S. over the last century. Today, reasonably well-funded defined benefit pension plans may receive up to 60 to 70 percent of total revenues from investment income.

Another advantage to employers from advance funding OPEB comes from the potential ability under GASB 45 to use a higher discount rate to value liabilities than under the PAYGO method. The



use of a higher discount rate will result in lower actuarial liability and expense calculations. For employers that are expected to contribute amounts equal to or greater than the ARC, a discount rate based on the long-term expected rate of return on the OPEB plan's assets would be used. Plan assets would most likely be invested in a portfolio of securities designed to generate a higher long-term rate of return similar to pension trust funds—maybe in the 7 to 8 percent range. Employers that continue to have no plan assets would use a discount rate based on the employer's own investments, which might be in the 1 to 3 percent range. Employers that have some plan assets but are expected to contribute less than the ARC would use a blended rate. Thus, the full advance funding of OPEB would generate both real cost savings from investment earnings and more favorable liability calculations.

Some employers may choose to fund part of their OPEB actuarial liability through the use of bond proceeds. OPEB obligation bonds contain many of the same characteristics as their sister debt instrument, pension obligation bonds. These bonds are basically arbitrage funding, in that the proceeds are placed in a plan trust and invested in equities, bonds, and other instruments that are expected to return a higher rate of return than the interest cost of the bonds. Savings are projected to be generated through lower annual costs for pension obligation bond debt service compared to the cost to pay all or a portion of the pension fund's unfunded actuarial accrued liability. The principal risk of this strategy is that investment returns may not meet expectations over the long-term and the bond issue could have the effect of actually adding costs during periods of weak investment returns instead of generating savings. Another pension obligation bond issue is that, due to debt limitations set by either policies or statutes, this type of debt may use up bonding capacity that might have been applied to other projects. While pension obligation bonds issued in the early 1990s have on average met with success to date despite several rocky years, those sold in the late 1990s have been disappointing. The success of any pension obligation bond or OPEB obligation bond in the future will depend on conservative planning and fortuitous market timing.

From a rating standpoint, OPEB obligations, like other cost pressures without offsetting resources, affect not only debt and management factors, but also financial. If any changes resulting from OPEB have the effect of adversely affecting an employer's financial position or flexibility, then credit quality may suffer.

MANAGEMENT CONSIDERATIONS RELATED TO OPEB CHANGES

As employers wrestle with policy decisions in response to information provided through implementation of the new OPEB reporting requirements, including the decisions to fund or not to fund and whether or not the existing benefit structure is to be maintained, they will be juggling multiple issues.

Competitive Position. The principal reason employers promise retirement benefits to employees is to help attract and keep qualified personnel. Like all employment sectors, state and local governments must offer to employees a combination of salary, benefits, and job satisfaction that will maintain adequate staffing to deliver the services required and at a level of quality expected by the community. To the extent that any diminution of benefits undercuts a government's competitive ability to hire good people, its mission may be compromised.

Affordability. When the OPEB valuations are completed, some employers may find that the advance funding of GASB 45 annual OPEB costs is just too expensive given the budget's resources. This is the point at which some of the options mentioned above to mitigate OPEB exposure may be considered. Are there feasible ways to lower the OPEB liability or should the old PAYGO practice simply be continued? Also under consideration will be any new revenue sources or areas where fees or taxes could be increased to cover the added costs. Given the recent pressures from other cost centers, including pensions, public safety, and health care (non-retiree), finding additional resources will be challenging in most cases.

Political Hazards. Even if increasing OPEB costs are "affordable," they may not be politically palatable. For example, private sector workers, as voters, who do not have as high a level of health care coverage as their local government employee neighbors, may resist any increases in government taxes or fees to cover higher OPEB contributions. Management will have to be sensitive to this issue.

Legal Issues. A major legal issue that is again being raised as part of the OPEB reporting change discussion is whether or not an employer can reduce this type of retiree benefit that has been promised to certain employees. Whereas many states have strong constitutional or statutory protections against taking away pension benefits that have been granted, the legal status of OPEB is frequently unclear. Also, pension protections have been bolstered by extensive case law over the decades. A further complicating legal factor is that most OPEB promises have been made through col-

lective bargaining agreements and these benefits may or may not be continued upon contract renewal. Even in the absence of a written agreement, state and local government employers may have reportable OPEB liabilities if the benefits are based on any substantive plan (one that is understood by the employer and its employees). As the changes in OPEB reporting advance, it is likely that related attempts to alter benefits in some cases will end up in the courts.

Rating Considerations. Another issue facing employers in their OPEB choices will be how their decisions will affect their bond ratings. Standard & Poor's views unfunded actuarial retiree healthcare obligations as debt-like in nature, similar to pensions. While a history of audited pension liability trends have been incorporated into individual state and local debt ratings, OPEB actuarial liabilities, most yet to be quantified, present some uncertainties. Given that in many cases the OPEB actuarial liabilities are expected to be large and that liabilities also are expected to vary widely from employer to employer, the key to maintaining a stable credit profile for employers will be how they manage these liabilities. From a rating standpoint, OPEB obligations, like other cost pressures without offsetting resources, affect not only debt and management factors, but also financial. If any changes resulting from OPEB have the effect of adversely affecting an employer's financial position or flexibility, then credit quality may suffer.

CONCLUSION

The new accounting and reporting rules for retiree healthcare benefits under GASB 45 are going to cast a bright light on this corner of state and local government employee deferred compensation. Based on the evidence to date, the difference between financing these benefits under the old PAYGO method and the new advance funding method is going to be significant. Employers in some cases will have to go back to the drawing board to retool their benefit packages if they wish to advance fund these liabilities. In addition to the financial implications, employers may also be hit with a variety of related factors – including political, legal, and bond rating issues – in the course of their OPEB review, compliance, and planning. As OPEB obligations take on greater urgency, management must respond with thoughtful, long-term solutions. ▮

Note:

1. Governmental Accounting Standards Board Statement No. 45 – *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, Issued June 2004.

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