

GASB 45 and Retiree Benefits

A Presentation to the Association of Town Finance Committees

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Topics

- Overview
- OPEB and GASB 45
- Case Study



Overview

- GASB 45 establishes financial reporting standard for Other Postemployment Benefits (OPEBs)
- Postemployment medical benefits are most significant
- Other postemployment benefits include:
 - Dental
 - Vision
 - Disability
 - Life insurance
 - Long term care

Overview

- Governmental employers generally report OPEB costs as current expenses and fund them on a pay-as-you-go basis
- GASB sees these benefits as similar to pension benefits:
 - Accrued while employed; paid during retirement
 - Costs should be recognized when service is rendered
 - Full cost accrued by the time benefits commence

GASB 45 OPEB Effective Dates

	GASB 45
Total Annual Revenues of the Sole or Largest Participating Employer in the Plan In the First Fiscal Year Ending After June 15, 1999	OPEB Statement will be Effective for that Employer for Periods <u>Beginning After</u>
Phase 1 Government --\$100 million or more	December 15, 2006
Phase 2 Government --\$10 million or more, but less than \$100 million	December 15, 2007
Phase 3 Government --Less than \$10 million	December 15, 2008

General Framework

- Costs for postemployment benefits are spread over the employees' working careers
- Accrued liability at date of initial application of new standards may be amortized over a period of up to 30 years
- Costs are determined through an actuarial valuation
- Valuation to be done in accordance with certain constraints (parameters) related to:
 - Definition of the plan – the "Substantive Plan"
 - Frequency of valuations
 - Actuarial methods and assumptions

The Substantive Plan

- The terms of the plan as understood by the employer and employees
- Evidenced by:
 - Written plan documents, other written communications
 - Established pattern of cost sharing
- Projected benefits based on benefits approved and communicated to members at time of valuation
 - Including legal or contractual caps on the employer's share, if the cap is assumed to be effective given its record of enforcement

The Substantive Plan

- In some cases, retirees pay a premium based on a blended rates for active and retired members
 - Particularly common for pre-65 retirees
- Difference between retiree-only premium and blended premium is treated as a postemployment benefit
- Example:
 - Pre-65 retirees pay a blended premium for pre-65 coverage
 - Implicit subsidy
 - Sponsor pays blended premium
 - GASB recognizes retiree-only premium and includes implicit subsidy

	Retiree	Retiree and Spouse
Retiree-only premium	\$582	\$1,164
Blended premium	\$286	\$572
Implicit subsidy	\$296	\$ 592

Valuation Parameters

- Valuation frequency – at least every
 - 2 years for plans with 200 or more total members
 - 3 years for plans with less than 200 total members
 - Sooner if a change occurs that significantly affects costs
- Actuarial methods
 - Entry age, frozen entry age, attained age, frozen attained age, projected unit credit, aggregate
 - If aggregate method, Unfunded Actuarial Accrued Liability (UAAL) and funding ratio must be based on entry age method
- Actuarial assumptions
 - Generally guided by Actuarial Standards of Practice
 - Interest rate assumption should reflect the yield on investments expected to finance the benefits

Investment Return Assumption

- Higher interest rate generates lower cost.
- OPEB assets held in trust, GASB allows assumed investment return to reflect the investments held in trust.
- OPEB assets not held in trust (e.g., are in a fund earmarked by the employer), assumed return may only reflect the return on assets available to the employer (e.g., short-term, fixed-income securities).
- Could mean the difference between a 7% return assumption and a 4% return assumption – a significant incentive for holding the assets in trust.
- Trusts include equivalent arrangements in which:
 - Employer contributions are irrevocable and dedicated to providing benefits in accordance with the terms of the plan, and
 - Fund assets are legally protected from creditors.
- Auditor approval important.

Annual OPEB Plan Expense

- Included in employer's income statement
- Need not be funded
- Annual Required Contribution (ARC)
 - Normal cost, plus
 - Amortization of unfunded actuarial accrued liability (UAAL)
 - Misleading term
- OPEB cost
 - ARC plus
 - Interest on OPEB obligation plus
 - Possible ARC adjustment
 - Annual accounting cost

Annual OPEB Plan Expense

- Actuarial Accrued Liability (AAL)
 - Liability allocated as of valuation date
 - Present value of benefits for those in payment status
 - Different values for those not in payment status
 - Depends on actuarial cost method
- Unfunded Actuarial Accrued Liability (UAAL)
 - Difference between AAL and assets held for satisfying promise

Net OPEB Obligation

- Included in employer's balance sheet
- Zero at date of initial application of new standards
- In subsequent years
 - Accumulated OPEB cost, less
 - Accumulated employer contributions
- Employer contributions include:
 - Benefit payments to an unfunded arrangement or
 - Amounts contributed to designated trust

Example

- Employer elects to continue to fund benefits on a pay-as-you-go basis
- Valuation discount rate – 4%
- Projections (in millions)

Year	ARC	Benefit Payments	Net OPEB Obligation at EOY	Annual OPEB Expense
1	\$6.0	\$2.2	\$3.8	\$6.0
2	\$6.1	\$2.3	\$7.8	\$6.3
3	\$6.2	\$2.4	\$11.9	\$6.5
4	\$6.3	\$2.5	\$16.2	\$6.8
5	\$6.4	\$2.6	\$20.6	\$7.0

Example

- Employer elects to fund ARC
 - Assets held in irrevocable trust
 - Benefit payments made directly from trust
- Valuation discount rate – 6.5%

Year	ARC	Employer Contribution	Net OPEB Obligation at EOY	Annual OPEB Expense
1	\$5.4	\$5.4	\$0	\$5.4
2	\$5.5	\$5.5	\$0	\$5.5
3	\$5.5	\$5.5	\$0	\$5.5
4	\$5.6	\$5.6	\$0	\$5.6
5	\$5.7	\$5.7	\$0	\$5.7

- Additional cash outlay: \$15.7 million (= \$27.7 – \$12.0)
- Reduction in expense: \$4.9 million (\$32.6 – \$27.7)
- Reduction in liability: \$20.6 (= \$15.7 + \$4.9)

Potential Impact – Financing

- Employers may consider issuing OPEB bonds to fully or partially fund the UAAL
 - Amortization of UAAL eliminated or reduced
 - Key considerations
 - Potential arbitrage
 - Proceeds irrevocably set aside
- Employers may consider funding ARC
 - Higher discount rate
 - Lower OPEB expense
 - Greater cash outlay

Funding Vehicles

- Health Savings Account (HSA)
 - Employee owned
 - Coupled with high deductible health plan
- Health Reimbursement Account (HRA)
 - No employee contribution
 - Reclassify mandatory employee contributions as employer contributions
- Voluntary Employee Benefit Association (VEBA)
 - Employer or employee contributions
 - Employer reduction of no value
- Code Section 115 Governmental Trust
 - Funded and operated like a VEBA or pension trust

Potential Impact – Plan Design

- Employers will consider possible changes in program design to reduce costs and liabilities
- Possible changes include:
 - Establishing caps on future employer subsidies
 - Tying subsidy to length of service and age at retirement
 - Increasing age and service requirement to qualify for benefits
 - Reducing or eliminating benefits for future hires
- Employer will also wish to consider addressing any implicit subsidies by negotiating new premium rates for retirees

Next Steps

- Complete an actuarial valuation of current program
- Evaluate potential design modifications
- Assess funding alternatives
 - Initial funding of UAAL
 - Funding levels
 - Funding vehicles

Case Study

- Preliminary calculations for a phase 2 entity
 - GASB 45 effective for 07/01/08 – 06/30/09
- Provides postemployment
 - Medical
 - Life Insurance
- Costs allocated to various entities
 - General
 - School
 - Public Safety
 - Lights
 - Sever
 - Water
- Currently pay-as-you-go
- 608 active employees
- 530 retirees and beneficiaries currently receiving benefits

Case Study

	Present Value of Future Benefits	Actuarial Accrued Liability	Normal Cost
In Payment Status			
– Gross Benefit	\$89.5	\$89.5	\$0
– Participant Contributions	\$19.2	\$19.2	\$0
– Net Benefit	\$70.3	\$70.3	\$0
Deferred Promise			
– Gross Benefit	\$104.7	\$63.9	\$4.0
– Participant Contributions	\$20.2	\$12.5	\$.8
– Net Benefit	\$84.5	\$51.4	\$3.2
Total			
– Gross Benefit	\$194.2	\$153.4	\$4.0
– Participant Contributions	\$39.4	\$31.7	\$.8
– Net Benefit	\$154.8	\$121.7	\$3.2

Dollars are in millions



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ARC For Year One

• Normal Cost	\$3.20
• Unfunded AAL (UAAL)	
– AAL	\$121.70
– Assets	0.00
– UAAL	\$121.70
• Amortization of UAAL	
– UAAL	\$121.70
– Amortization Factor (30 years at 5%)	16.14
– Amortization	\$7.54
• Interest at Year-End at 5%	
– Normal Cost	.16
– Amortization	.38
• ARC	\$11.28

Dollars are in millions



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Assumptions

Discount Rate	5%	
Health Care Trend Rates	<u>Year</u>	<u>Rate</u>
	1	8.0%
	2	7.0%
	3	6.0%
	4	5.0%
	Ultimate	4.5%
Mortality	RP-2000 Healthy Lives	
Turnover Rate	Function of job status and years of service	
Eligibility	Retirement at age 55 with 10 years of service or Retirement at any age with 20 years of service	
Retirement Rates	Function of age 10% at 45 100% at 65	

Implicit Subsidy

Total Annual Premiums		
Pre-65		
	Single	Family
PPO	\$9,003	\$24,489
HMO	\$5,638	\$15,323
Post-65		
Medicare Enhanced Supplement	\$4,753	\$9,507
First Seniority	\$2,664	\$5,328
Participant Cost-Sharing (Percentage of Total Premiums)		
Pre-65		
PPO	20%	20%
HMO	10%	10%
Post-65		
Medicare Enhanced Supplement	39%	39%
First Seniority	30%	30%

Implicit Subsidy

Blended - Participant Contribution

Pre-65 \$1,302 per person

Post-65 \$1,702 per person

This reflects the premium schedule and participant cost-sharing schedules as prior slide and the specific population.

Costs Used for GASB 45 Calculations	
Retirees and Spouses	
Age	Incurred Medical Costs --Annual per Capita
Under 55	\$9,493
55 - 59	\$11,606
60 - 64	\$14,107
65 - 69	\$6,403
70 - 74	\$5,723
75 - 79	\$6,532
80 - 84	\$8,673
85 - 89	\$11,359
95 - 99	\$10,364

Plan Design Strategies for Reducing Impact of GASB 45

- Employers will consider possible changes in program design to reduce costs and liabilities
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