Public Employee Post-Employment Benefits Commission Testimony

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Role of the Rating Agencies

- **Credit Evaluation of:**
  - **Issuer's Ability and Willingness to pay**
  - ***Relative to Other Tax-Exempt Issuers***
- **Municipal long-term ratings and definitions**
  - Issuers or issues rated **Aaa** demonstrate the strongest creditworthiness
  - Issuers or issues rated **Aa** demonstrate very strong creditworthiness
  - Issuers or issues rated **A** present above-average creditworthiness
  - Issuers or issues rated **Baa** represent average creditworthiness

Municipal Bond Rating Scale

"Average credit loss rates on Moody's-rated municipal bonds have been extremely low, in fact, lower than the loss rates on Aaa-rated corporate bonds...

"Municipal investors have demanded, and rating agencies have provided, finer distinctions within a narrower band of potential credit losses than those provided for corporate bonds...

In order to satisfy the needs of highly risk averse municipal investors, Moody's credit opinions about US municipalities have, since their inception in the early years of the past century, been expressed on the ***municipal* bond rating scale**, **which is distinct from the *corporate* bond rating scale** used for corporations, non-US governmental issuers, and structured finance securities."

Moody's US Municipal Bond Rating Scale, November 2002

Fundamental Rating Factors

- Economy and tax base
- Finances
- Debt level and structure
- Management
- Addressing Other Post Employment Benefits (OPEB) liability could affect 3 of the 4 factors, but is only one component of those factors.

OPEB Disclosure is a Good Thing…

- Provides analysts, investors and policy-makers with better information about the magnitude of existing commitments.
- Provides policy-makers contemplating benefit changes with better information about long-term costs.

OPEB UAAL and The Rating

- The typical government provides fairly generous OPEB benefits and has not prefunded.
- These commitments result in a large number when expressed on a present value basis.
- "Typical" OPEB exposure is already built into the ratings
- Even if converted into debt tomorrow, the typical Unfunded Accrued Actuarial Liability (UAAL) can still be manageable.
- Government's response to OPEB information is more important than the number itself.

Where Is Government on the Learning Curve

1. What's OPEB?
2. We're not quite ready to perform an actuarial study
3. We've had one (or more) studies performed and are trying to figure out how to deal with the results
4. We've developed and evaluated options such as changing benefits, incorporating Actuarially Required Contribution into our annual budget, pre-funding, and establishing a trust
5. We've begun implementing our preferred option(s) for addressing our OPEB liability

Likely Focus of Moody's Analysis

- Size of the UAAL normalized to measures such as payroll, budget and taxbase, relative to peers.
- OPEB costs as a percent of budget now and over the next 10, 20, 30 years, assuming no change in current benefits and funding strategy.
- Assumptions underlying estimates/projections.
- Actions taken to control the growth in OPEB costs relative to budget.
  - Changes in benefit levels, eligibility, and vesting.
  - Partial or full prefunding (with or without the use of OPEB funding bonds).

Long Term, OPEB May Lead to Rating Changes

Factors that COULD result in a downgrade:

- An OPEB liability which, when normalized, is significantly larger than that of peers.
- Unusually optimistic assumptions underlying estimates.
- Absence of a credible plan to keep OPEB costs manageable within budget.
- Inability or unwillingness to change benefits.

OPEB and Ratings: Thoughts to Remember

- In the short term, an issuer doesn't have to fund the UAAL to maintain rating.
- Issuance of OPEB funding bonds is not, by itself, a credit negative.
  - When a government has decided, for sound reasons, to prefund all or part its liability, funding bonds can be appropriate part of the funding plan.
  - Expected savings should be weighed against loss in flexibility and tolerance for investment risk.