Public Employee Post-Employment Benefits Commission

Other Post Employment Benefits (OPEB) Accounting Standard – GASB 45

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GASB 45
Agenda

Comparing OPEB From One Agency to Another?

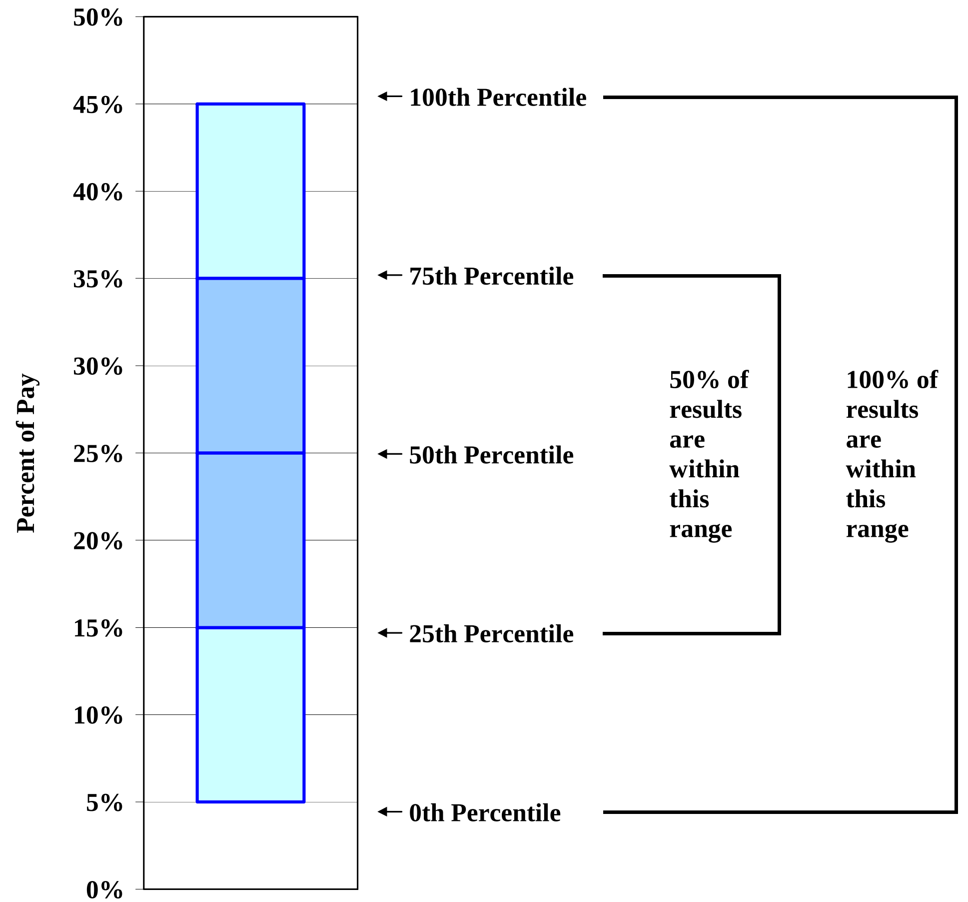
"How do our numbers (benefits) compare with other agencies?"

- Surveys are challenging:
  - Benefits vary significantly
  - Healthcare plan options after retirement vary significantly
  - Terminology varies significantly
  - Within an Agency benefits can vary significantly
  - Survey responder may not be sophisticated
- No perfect way to answer the above question

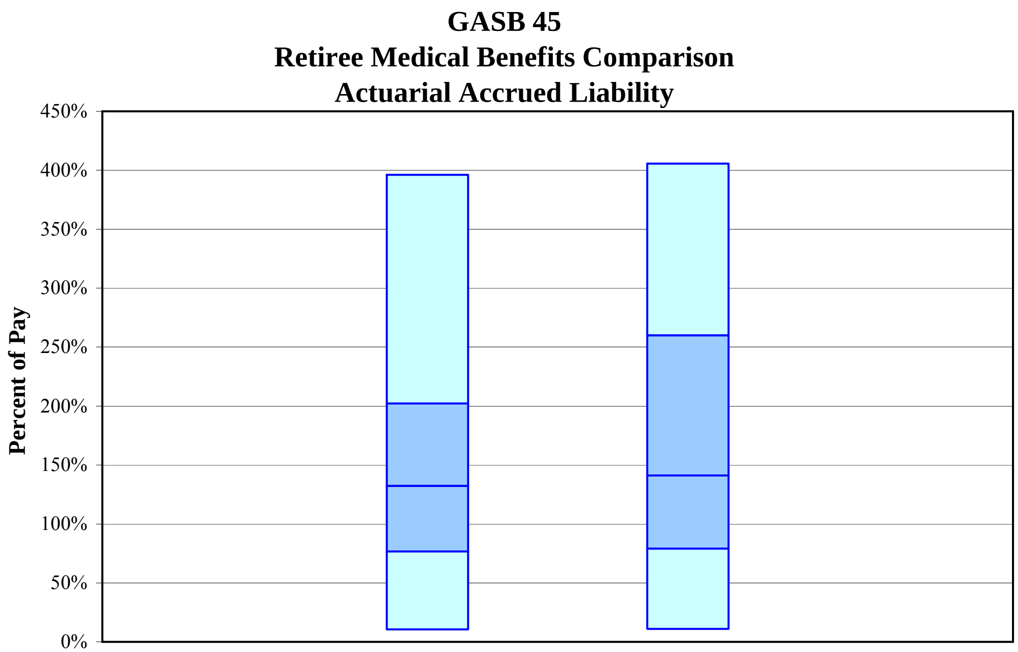
Comparing OPEB From One Agency to Another?

- Agencies generally have revenue sources consistent payroll
- Decided to compare actuarial results to "Pensionable" Compensation
  - Actuarial Accrued Liability – Value of benefits "earned" to date or how much should agency have set aside
  - Normal Cost – Value of benefits being "earned" during year
  - Annual Required Contribution – How much should the agency be contributing
  - PayGo – 1st and 10th years in projections
- PayGo rather than pre-funding assumptions:
  - Discount rates 4-5%
  - UAAL Amortization period 20 years

Bartel Associates GASB 45 Data Base
Sample Percentile Graph

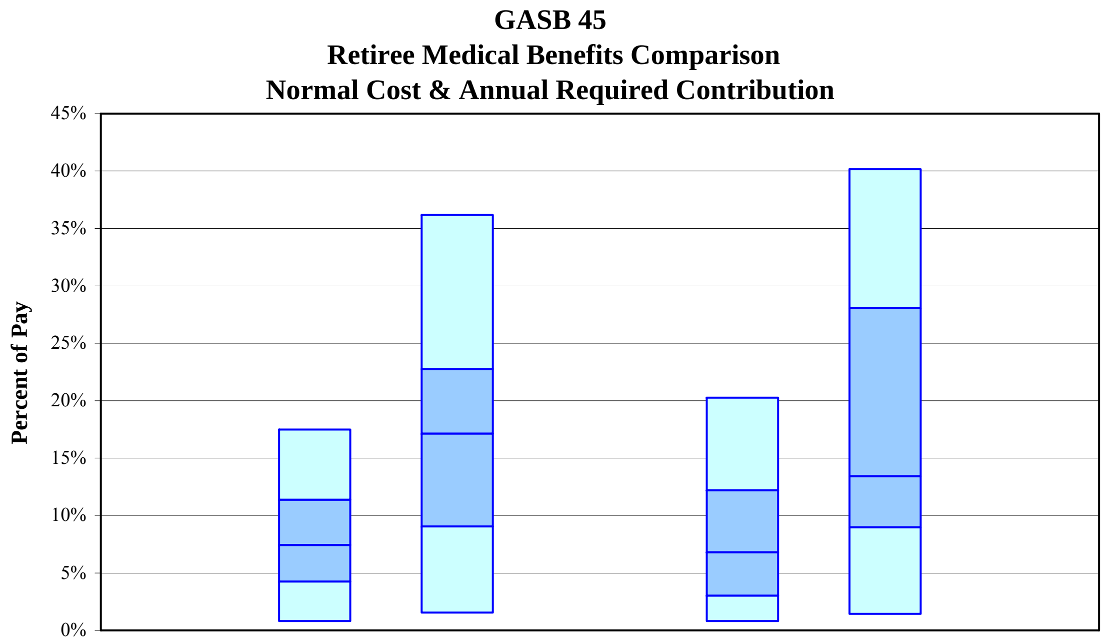


Bartel Associates GASB 45 Data Base
Actuarial Liability – As % of Payroll



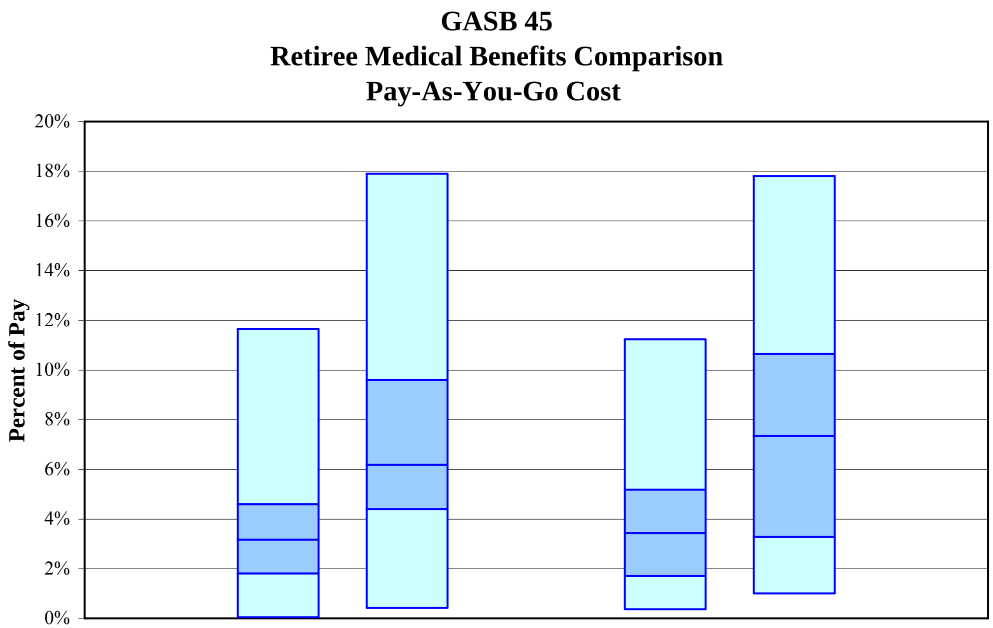
	Miscellaneous	Safety
100th Percentile	396%	406%
75th Percentile	202%	260%
50th Percentile	132%	141%
25th Percentile	77%	79%
0th Percentile	11%	11%

Bartel Associates GASB 45 Data Base
Normal Cost & ARC – As % of Payroll



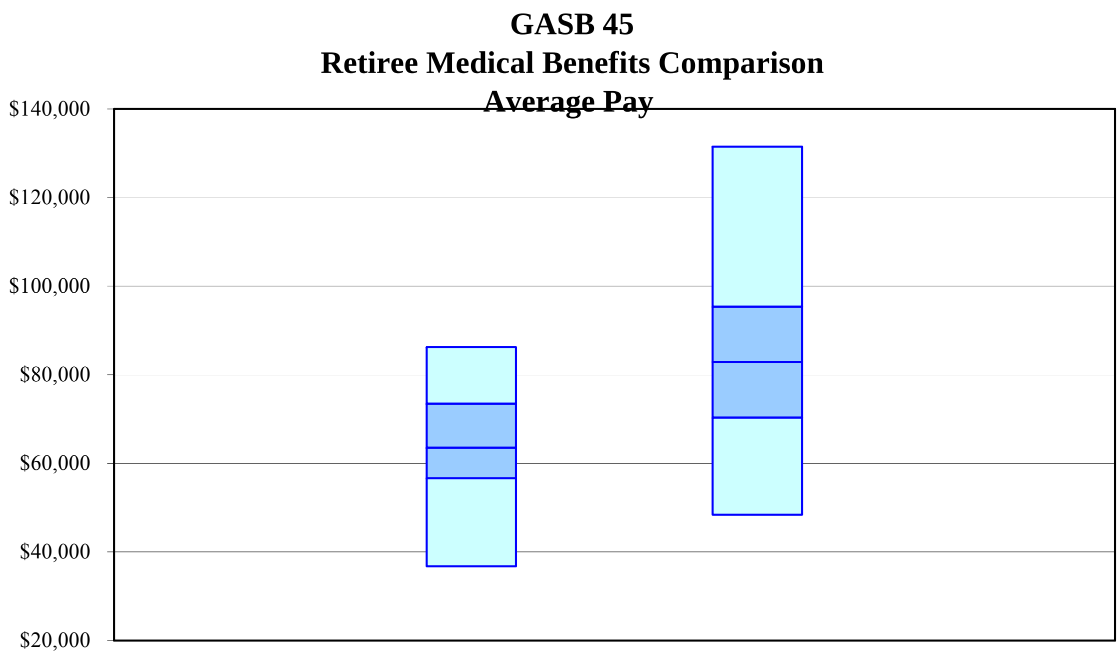
	Miscellaneous		Safety	
	NC	ARC	NC	ARC
100th Percentile	17.5%	36.2%	20.3%	40.1%
75th Percentile	11.4%	22.8%	12.2%	28.1%
50th Percentile	7.4%	17.1%	6.8%	13.4%
25th Percentile	4.3%	9.0%	3.0%	9.0%
0th Percentile	0.8%	1.5%	0.8%	1.4%

Bartel Associates GASB 45 Data Base PayGo As a% of Payroll



	Miscellaneous		Safety	
	1st Yr	10th Yr	1st Yr	10th Yr
100th Percentile	11.7%	17.9%	11.2%	17.8%
75th Percentile	4.6%	9.6%	5.2%	10.6%
50th Percentile	3.2%	6.2%	3.4%	7.3%
25th Percentile	1.8%	4.4%	1.7%	3.3%
0th Percentile	0.1%	0.4%	0.4%	1.0%

Bartel Associates GASB 45 Data Base Average Payroll



	Miscellaneous	Safety
100th Percentile	$86,200	$131,500
75th Percentile	$73,500	$95,400
50th Percentile	$63,500	$82,900
25th Percentile	$56,700	$70,300
0th Percentile	$36,800	$48,400

Retiree Healthcare Strategies

1. Do Nothing
   - Continue PayGo
2. Pre Fund Into Irrevocable Trust:
   - Fiscally Prudent, if Assets Diversified
   - Financially Challenging
   - Significant Cash Investment Compared to PayGo
3. Change Benefit

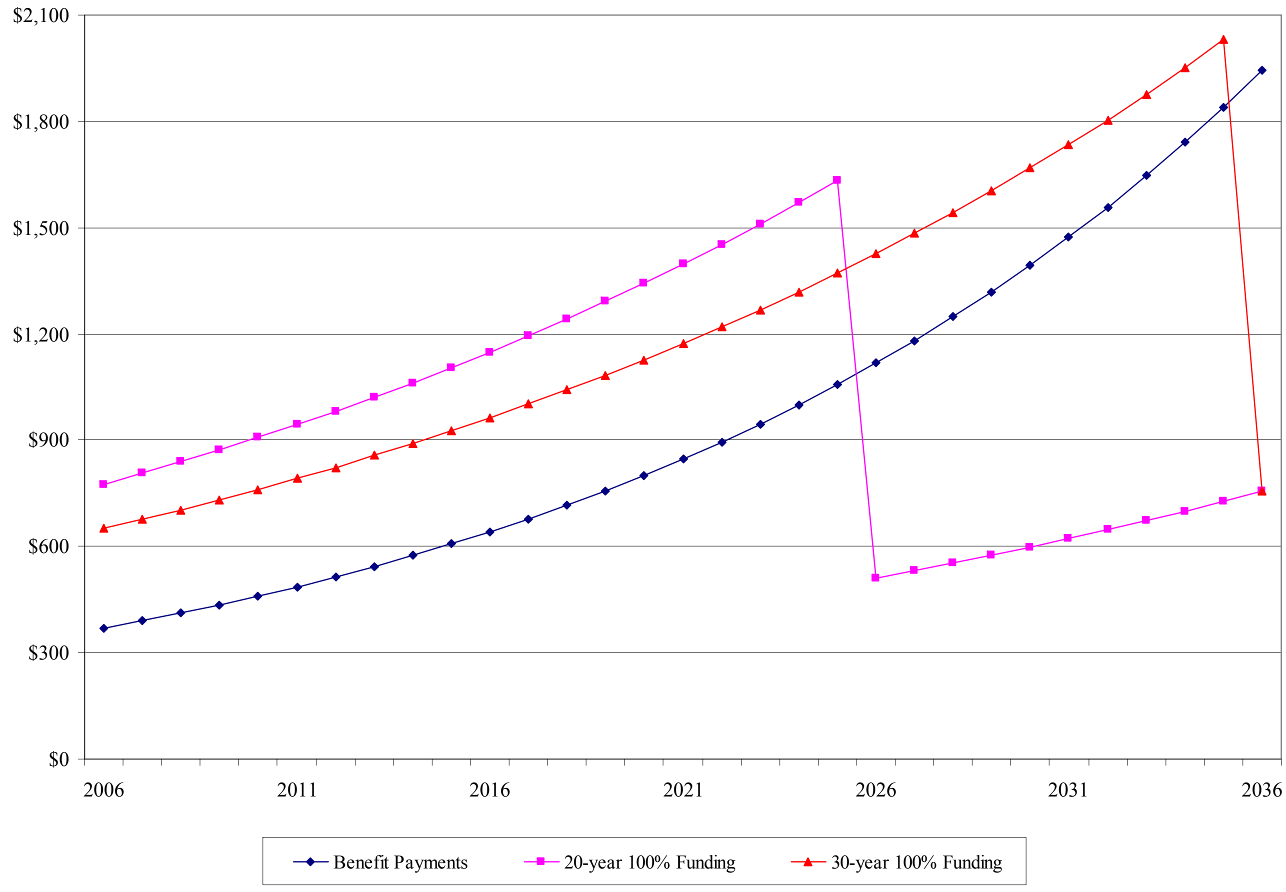
1. Reasons to Do Nothing

- We've done just fine with PayGo, why change?
- Doing Something Requires Either
  - Cash or
  - Changing Benefit
- State and/or Federal Government May:
  - Solve the problem?
  - Not reimburse prefunding amount?
- Numbers are just "Actuarial Mumbo Jumbo"

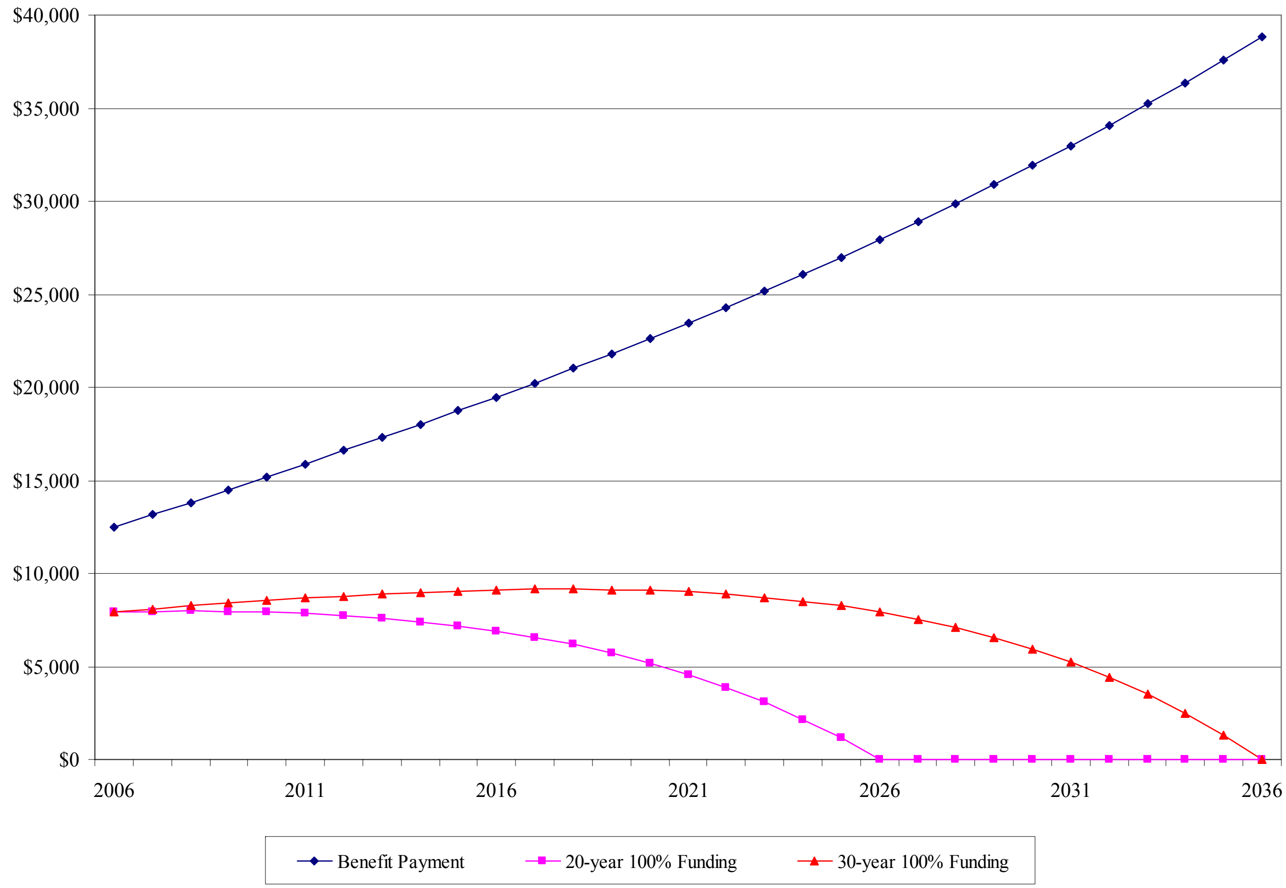
2. Reasons to Pre-Fund OPEB

- Investment return can help pay for benefits
- If it's appropriate for pensions then why not OPEB?
- Tax/Rate payer generational equity
- Bond rating
- Political pressure
- If you can't afford to pre-fund then can you afford the benefit?
- Doing nothing costs more than doing something

2. ARC Projections



2. UAL Projections

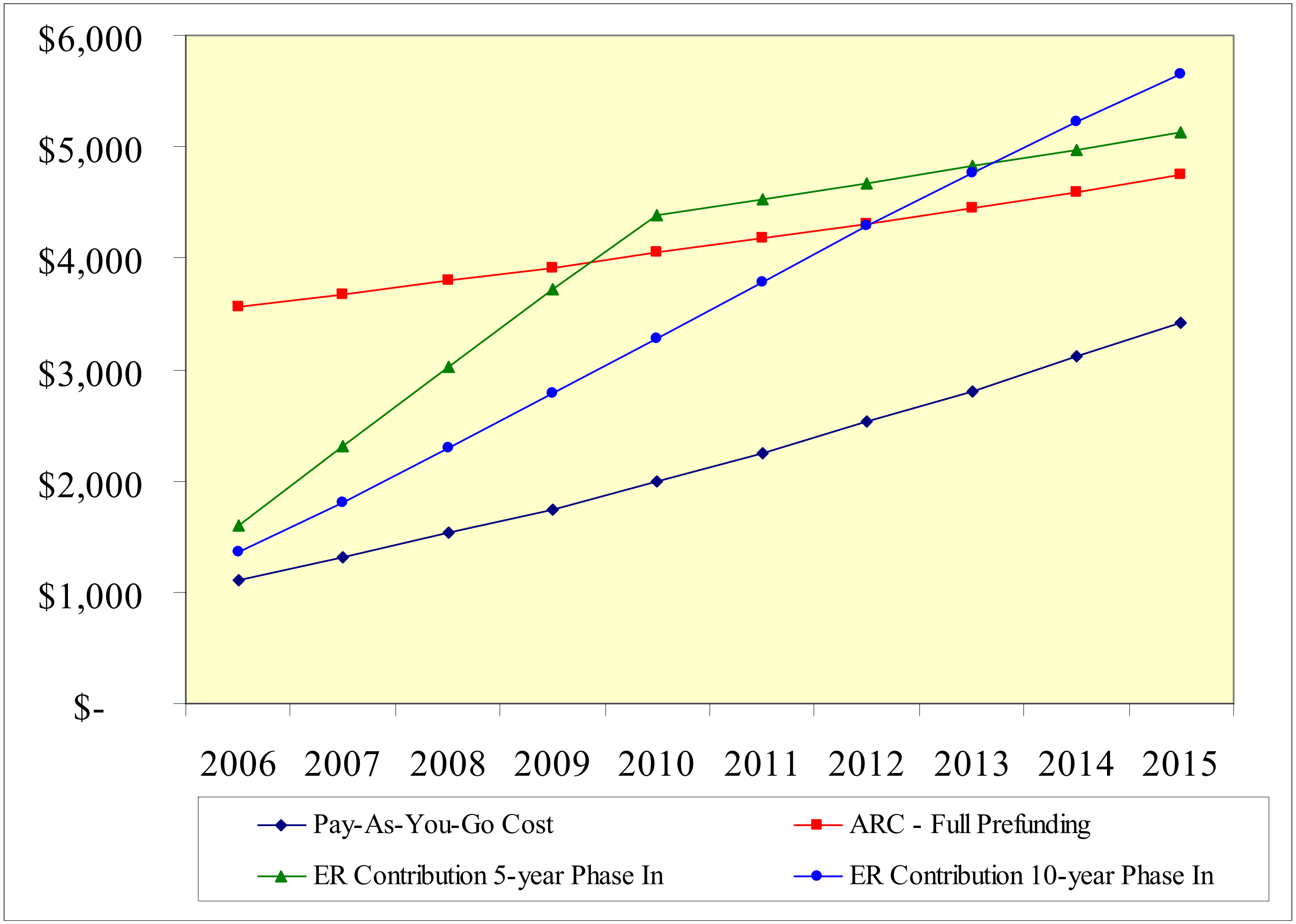


2. What Will CA Agencies Do?

- Pay Full ARC ≈ 10%
  - Some with established Internal Service Funds
- 5-10 Year Phase-In: ≈ 35%
  - Year 1 PayGo
  - Year 2 PayGo + 10% (ARC – PayGo)

    ↓ ↓
  - Year 11 Full ARC
  - Allows time for budgeting
  - Likely acceptable for Bond rating agencies
- Consider target funding level: ≈ 5%
  - 80% of Actuarial Liability in 25 or 30 years
- Unknown ≈ 30%
- Continue PayGo ≈ 20%

2. Cash Flow Projections



3. What Plan Design Alternatives Are Agencies Considering?

- Uncertainty on Legal Issues
- Majority Will Likely Make No Changes
- Majority Bringing Issue Into Bargaining Process
- Those Considering Changes:
  - Eliminate Implied Subsidy
  - Two Tier System
    - Defined Contribution (individual account)
  - Redesign Benefit:
    - Encourage DC

What Is It?

- "OPEB" (**<u>O</u>**ther than pension **<u>P</u>**ost **<u>E</u>**mployment **<u>B</u>**enefits
  - Retiree healthcare:
    - Medical
    - Dental
    - Vision
    - Life
  - Other
- Historically accounted for as Pay-As-You-Go:
  - Generally ignored until employees stop rendering service
  - Pay $1 account for $1

What/Who Does It Apply To

- New Standard:
  - Accrual basis accounting
  - As employees render service
- Applies to All Public Sector Entities
- Effective dates based on GASB 34 Phase in:
  - GASB 34 Phase I ≥ $100 million December 15, 2006
  - GASB 34 Phase II $10-100 Million December 15, 2007
  - GASB 34 Phase III < $10 Million December 15, 2008

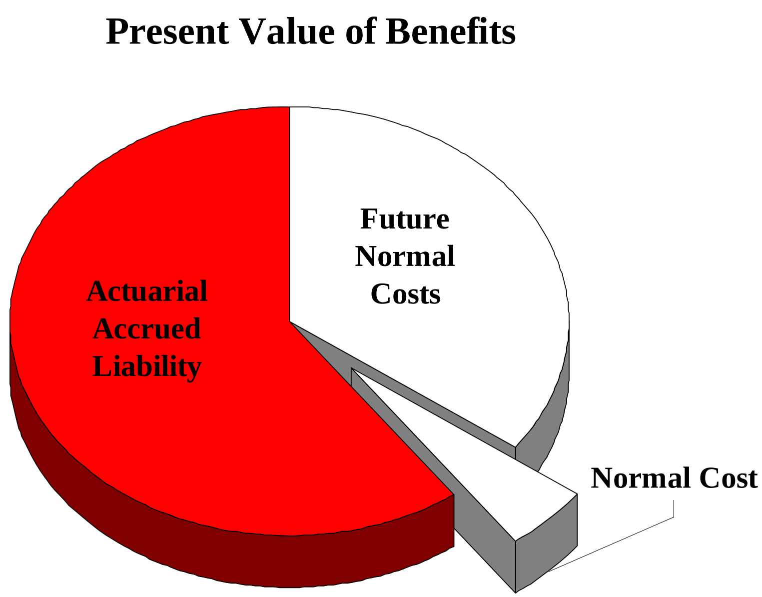
Government Wide & Proprietary Fund Financial Statement Implications

- Accrue Difference Between :
  - Annual Required Contribution (ARC) and
  - Amounts actually paid (pay-as-you-go cost)
- Disclosure:
  - ARC
  - Unfunded Actuarial Liability
  - Net OPEB Obligation

Other Implications

- Encourages, Does Not Require, Funding
- Numbers Are Large
- Bond Rating:
  - Have A Plan!

Definitions



- **PVPB - Present Value of all Projected Benefits:**
  - Discounted value (at valuation date – e.g. 6/30/06), of all future expected benefit payments based on various (actuarial) assumptions

Definitions

- **Actuarial Accrued Liability (AAL):**
  - Discounted value (at valuation date) of benefits earned through valuation date [value of past service benefit]
  - Portion of PVB "earned" at measurement
- **Current Normal Cost (NC):**
  - Portion of PVB allocated to (or "earned" during) current year
  - Value of employee and employer current service benefit

Annual Required Contribution
(ARC)

- Actuarially determined
- Includes:
  - Normal Cost
  - Amortization of Unfunded Actuarial Accrued Liability:
    - Level $ or % pay
    - Open or closed amortization period
- Level % of Pay or Level $
- Simplified method for “Plans” with < 100 live

Annual OPEB Cost
(AOC)

- Year 1: AOC = ARC
- If actual contribution always = ARC, then AOC = ARC
- If historically actual contribution ≠ ARC, then AOC = ARC, adjusted for:
  - Interest on NOO and
  - Amortization of NOO

Annual OPEB Cost
(AOC)

- Amortization Period:
  - Open or closed group
  - Level $ or % of pay
  - Maximum 30 years;
  - Minimum 10 years for:
    - Asset method gains
    - Cost method gains

Net OPEB Obligation
(NOO)

- Historical difference between:
  - Annual OPEB Cost (AOC) and
  - Actual contributions
- If actual contribution always = Annual Required Contribution (ARC), then NOO = 0
- First year Contribution ≠ ARC, then NOO (End of Year) =

  \+ Annual OPEB Cost

  \- Actual contributions
- Subsequent years, NOO (End of Year) =

  \+ NOO (Beginning of Year)

  \+ Annual OPEB Cost

  \- Actual contributions

Simplified Example

(Assumes 0% Interest and Other Simplifying Assumptions)

If:

	Age	Service	Wages
■ At Hire:	35	0	-
■ Current:	45	10	$ 60,000
■ At Retirement:	60	25	-

Then:

■ $PVPB_{45}$	=			$ 100,000
■ AAL_{45}	=	(10/25) x 100,000	=	40,000
■ Assets	=			0
■ UAAL	=			40,000
■ $NC_{45/46}$	=	(1/25) x 100,000	=	4,000

Simplified Example

(Assumes 0% Interest and Other Simplifying Assumptions)

Normal Cost	=		$ 4,000
UAAL Amortization	=	(1/20) x 40,000 =	2,000
ARC - $	=		**6,000**
ARC - %	=	6,000 / 60,000 =	10%
Pay as You Go Cost			**0**

Net OPEB Obligation		**PayGo Without Trust**	**Pre Fund With Trust**
BoY NOO	=	$ 0	$ 0
+ ARC	=	6,000	6,000
- Payments	=	0	(6,000)
EoY NOO	=	6,000	0

Simplified Example

(Assumes 0% Interest and Other Simplifying Assumptions)

If:	Age	Service	Annual Payment
■ At retirement:	60	25	-
■ Current Age:	62	25	$ 4,000

Then:

■ $PVPB_{62}$	=			$ 100,000
■ AAL_{62}	=	(25/25) x 100,000	=	100,000
■ Assets	=			0
■ UAAL	=			100,000
■ $NC_{62/63}$	=	(0/25) x 100,000	=	0

Simplified Example

(Assumes 0% Interest and Other Simplifying Assumptions)

■ Normal Cost	=			$ 0
■ UAAL Amortization	=	(1/20) x 100,000	=	5,000
■ ARC - $	=			**5,000**
■ ARC - %	=			N/A
■ Pay as You Go Cost				**4,000**

Net OPEB Obligation		**PayGo Without Trust**	**Pre Fund With Trust**
■ BoY NOO	=	$ 0	$ 0
■ + ARC	=	5,000	5,000
■ - Payments	=	(4,000)	(4,000)
■ EoY NOO	=	1,000	0

Implied Subsidy

Implied vs. Cash Subsidy

- Cash Subsidy – Agency Reimbursement
  - e.g. 1st $200 of monthly premium, with retiree paying difference
- Implied Subsidy –Retirees pay pooled active & retiree rates vs. retiree only rate
- "Community Rated" plans do not need to value Implied Subsidy
  - Most agencies participating in CalPERS Healthcare (PEMHCA) will be considered Community Rated
  - < 1-2% of total plan experience
- GASB Q&A puts responsibility for determining Community Rated into actuary's hands

Key Actuarial Assumptions

- Discount Rate:
  - Used to calculate present values
  - Long-term rate
  - Based on source of funding
  - Pay-as-you-go discount rates 4-5%
  - Pre-fund - Qualifying trust or equivalent 4-8%
- Healthcare and/or $ Cap Trend
- Retirement Rates
- Participation Rate