

“Managing the Impact of GASB Statement 45” New York State Association of Counties

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Standard & Poor's
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Other Post Employment Benefits

Preview:

- Significance of OPEB for governments
- How OPEB fits into the rating process
- Credit implications

Post Retirement Costs: What are we talking about?

- **Other Postemployment Benefits (OPEB)**
 - Healthcare
 - Life Insurance
 - Dental
 - Other

OPEB Status

S&P's Report: **States Are Quantifying OPEB Liabilities And Developing Funding Strategies As The GASB Deadline Nears** – 11/12/07 shows the following:

- 40 of 50 states have completed valuations
- Based on the reports done to date, OPEB liabilities total \$357 billion to \$394 billion for the states (the range reflects valuations that show the a liability with and without pre-funding);
- Range of liabilities is enormous -- \$52 for North Dakota to \$58.1 billion for New Jersey
- Median liability: \$3.2 billion-\$4.1 billion
- Average Liability: \$9.2-\$10.1 billion

OPEB Status

- Comparisons between states are very difficult because there is broad differences in what is measured/included for each state and there is significant variation in the actuarial methods and assumptions used to calculate the liability.
- About 15 states have taken steps to begin to formally address the liability. This would include establishing a trust; implementing benefit changes or providing resources to begin to fund the liability.

Significance of GASB 45

- It focuses attention on an important national (and global) issue: funding retiree healthcare
- The resulting actuarial valuations and new reporting will provide for greater transparency
- Disclosure will lead to an examination of the ability to maintain the current benefit levels over the long term
- Clearly identifies future funding liabilities

Significance of GASB 45...continued

Current {OPEB} financial reporting generally fails to:

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

Source: GASB Statement No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions

How OPEB fits into the rating process

- Pensions and OPEB touch ratings in in three of four key areas we look at in establishing state credit ratings:
- Management,
- Finances, and
- Debt

Rating Factors: Management

- Are the OPEB obligations fully understood by management?
- If liabilities are material, what are the options to manage the liability and is there a clearly articulated strategy in place?
- Where does the OPEB problem rank in relation to other planning priorities?
- How conservative (or aggressive) are the methods and assumptions being used to determine OPEB liabilities and plan for the future?

Rating Factors: Financial

- While there is no requirement to fund OPEB under GASB, how do the commitments impact the overall cost structure?
- Can the budget afford the OPEB ARC or an escalating PayGo scenario?
- Will total carrying charges of bond debt service, pension contributions, plus OPEB contributions be sustainable given existing (or projected) resources?
- Legal and practical ability to manage OPEB costs

Rating Factors: Debt

- What is the legal obligation of the employer (how “debt-like”) to meet retiree healthcare obligations?
- How does OPEB alter the total long-term liability landscape for the employer: bonded debt + pension liabilities + OPEB liabilities?

NOTE: Pension/OPEB will not appear on the debt statement used to analyze and report on debt ratios in our public finance credit reports unless bonds are issued.

Credit Implications of OPEB

- Unlike pension liabilities, the effects of which have been incorporated into S&P's ratings for decades, the new OPEB reporting represents new, more specific information about an employer's total long-term liabilities
- While pension liabilities have been established for some time and changes are analyzed annually, we are seeing a wide range of OPEB liability exposure as the actuarial valuations become available.
- We would expect any employer that has an OPEB liability quantify it through an actuarial valuation
- The next step is to determine if the current benefit structure is sustainable

Credit Implications of OPEB...continued

- If PayGo OPEB costs or pre-funding amounts under GASB #45, if applicable, are projected to strain the budget, willingness and flexibility to manage these costs will be a significant factor in the credit review process
- If bonding is being considered, is it part of an overall debt and liability management plan
- The key to preserving creditworthiness in the face of pension/OPEB pressures will be how these liabilities are managed
- To the extent that OPEB cost pressures weaken financial position or flexibility and are not managed, credit quality may suffer

State Strategies to Manage OPEB

- States have embraced a range of strategies to begin to address liability
- Actions to date include the following:
 - Establishing trust funds
 - Reducing benefits
 - Health care cost containment
 - Increasing contributions
 - One state has moved to ARC funding (Utah)

Broader Concerns for States

- State action may be necessary for local governments to deal with the liability
- The ability of local governments to absorb OPEB liabilities over time will demand state interest
- If there are broad reductions in benefits, where will these retirees turn for health care?

NOT an effective OPEB management strategy



Standard & Poor's Commentary on Pension/OPEB

Date Published	Article Title
19-Nov-07	OPEB Obligation Bond Funding Strategies Offer Risks and Rewards
12-Nov-07	U.S. States Are Quantifying OPEB Liabilities And Developing Funding Strategies As The GASB Deadline Nears
26-Jun-07	California's OPEB Liabilities Are Prompting A Review Of Future Funding Decisions
5-Jun-07	New Texas Law Affecting State And Local OPEB Reporting Will Have No Immediate Rating Impact
27-Feb-07	Improved U.S. State Pension Funding Levels Could Be On The Horizon
4-Dec-06	Credit FAQ: OPEB Liabilities Pose Minimal Near-Term Rating Risk For Public Finance Credits
26-Sep-06	An Aging Population Challenges U.S. State Budgets And Renews Interest In Health Care Reform
11-Aug-06	How Big U.S. Cities Are Faring With The Pension Fund Meltdown
15-Jun-06	Accounting for OPEB Liabilities: Can State & Local Governments Cope?
3-May-06	Funding OPEB Liabilities: What It Means For Minnesota's Local Governments
15-Dec-05	Funding OPEB Liabilities: Assessing The Options

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Addressing Retiree Health and Other Legal Obligations Under GASB 45

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December 12, 2007

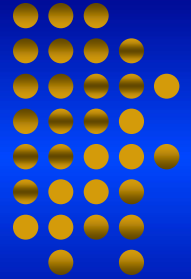


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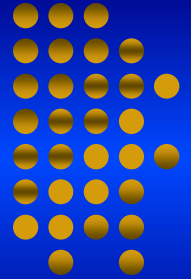


Potential OPEB Obligations

- Retiree Health – Current Retirees
- Retiree Health – Future Retirees



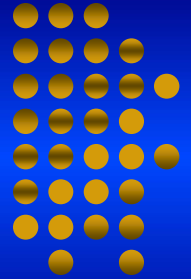
Legal Analysis



- Two fundamental issues
 - What rights does the County have under its current obligations to control the costs of retiree health benefits?
 - What steps can the County take to change its current obligations to control the costs of retiree health benefits?



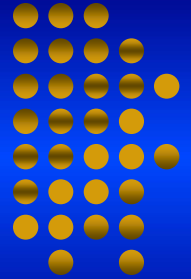
Sources of Obligations



- Collective bargaining agreements
- Ordinances and resolutions
- Employment policies
- Individual contracts and quasi-contractual obligations (e.g., letters and representations to employees)



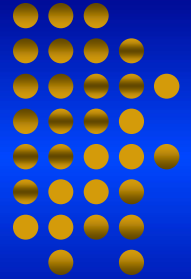
Legal Constraints



- Terms of existing obligations
- Taylor Law duty to bargain
- Adjudicating claims over changes to retiree health benefits



“Vesting” of Retiree Health Benefits

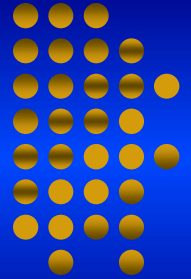


Key Question: Are the health benefits of retirees vested?

- Commitment to provide lifetime benefits
- Statement of current intention vs. legal obligation
- Sunset of benefits with end of labor agreement term
- Commitment to provide some benefits but ability to affect plan design
 - 1) benefits
 - 2) co-payments
 - 3) deductibles
- Benefits tied to active employees in some fashion



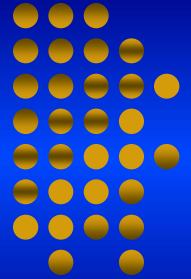
Taylor Law Bargaining Obligations



- Public employees are required to negotiate with recognized employee associations over terms and conditions of employment
- Health insurance for active employees is a mandatory subject
 - 1) health insurance for actives
 - 2) health insurance for actives post-retirement (future retirees)
- Health insurance benefits for retirees who retired under prior agreements is a non-mandatory subject of bargaining



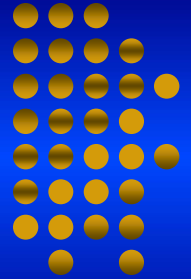
Modifying Health Benefits for Current Retirees



- Retirees under current CBA
 - Potential improper practice to unilaterally change benefits
- Retirees under previous CBA
 - apply contract terms
 - voluntary negotiations with Union
 - legal proceedings to adjudicate rights
- Reservation of rights clause



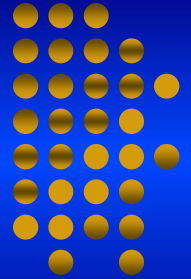
Negotiating Retiree Health for Actives and Future Retirees



- Mandatory subject of bargaining
- Triborough Law and maintenance of status quo
- Voluntary agreement with Union
 - 1) incentive to negotiate
 - 2) leverage based on ambiguities
 - 3) leverage based on economic factors
 - 4) impasse resolution mechanisms



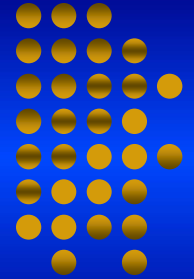
Adjudicating Retiree Health Claims – Current Retirees



- Forum: Arbitration or court action
- Proper parties
 - 1) Union
 - 2) affected employees
 - 3) class action vs. individual claims
- Risk of inconsistent results



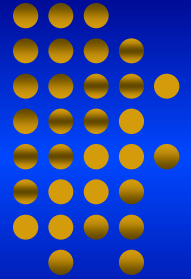
Case Law Examples



- City of Geneva – no right to continued health benefits provided by past practice but not under an express CBA provision
- Village of Hamburg – retirees may have enforceable rights under CBA or under statements creating implied promises of continued benefits



Case Law Examples

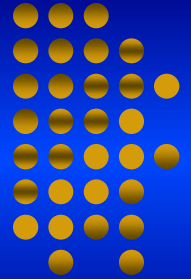


- City of Schenectady (Della Rocco) – where CBA stated that the employer would provide a certain level of coverage for retirees, entitlement to such coverage required throughout retirement
- City of Schenectady (Myers) – practice of paying Medicare Part B premiums and providing other retiree health coverage, post expiration of agreements under which retirees retired, evidence of lifetime coverage

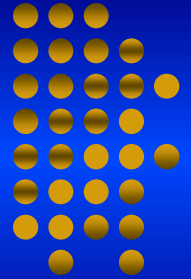


Proof Issues

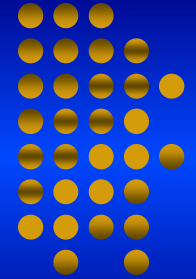
- Contract language
- Past practice
- Bargaining history
- Resolutions
- Historical documentation is critical



Strategic Objectives when Negotiating Retiree Benefits



- "Float" with actives
- Control plan design
- Ability to increase contributions
- Coordination with Medicare
- Anticipate possible federal reform
- Reservation of rights



Questions?



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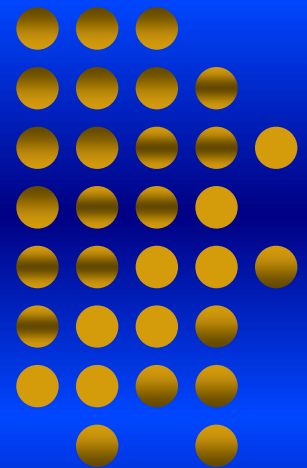
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**“Managing the Impact of GASB Statement 45”
New York State Association of Counties**

▪Roscoe Haynes
Principal, Consulting Actuary



Design Options Baseline Scenario

Retiree Medical Design Options

Percent of cost paid by employer based on employee's length of service:

less than 10 years	100%
10-14 years	100%
15-19 years	100%
20-24 years	100%
25-29 years	100%
30-34 years	100%
35+ years	100%

Percent of cost paid by employer for:

Pre-65 coverage	100%
Spouse coverage	100%

Dollar cap on the portion of the cost paid for by the employer

- no cap
- 3% increase
- no increase

Assumptions

Discount rate 7.50%

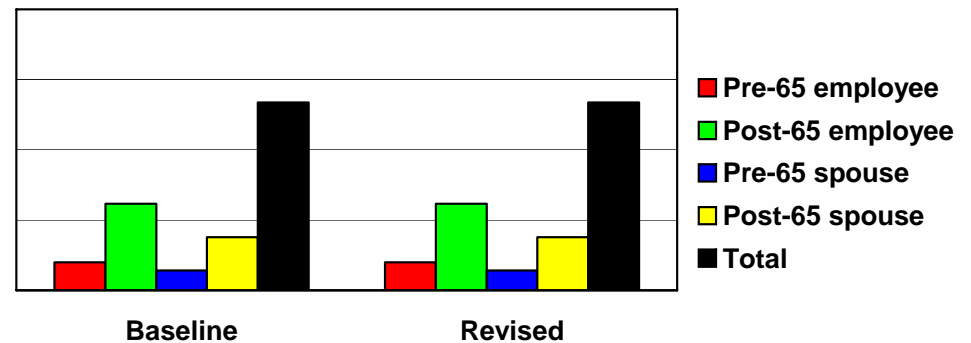
Medical inflation rate

- Higher
- Moderate
- Lower

At what ages are most employees assumed to retire

- Older ages
- Younger ages

Typical liability for a hypothetical employer



These results are illustrative only. The impact of changing benefit features or actuarial assumptions will depend on many factors, including the current retiree medical benefits, the demographic characteristics of the covered population, the actuarial cost method and assumptions, and so forth. Please contact your Milliman consultant for an evaluation of your retiree medical design options.



Sharing Risk with Retirees

- Cost Increases (trend, utilization, etc)
- Longevity
- Retirement Age
- Termination of Employment
- Investment Return
- Defined Contribution Plans
- Hybrid plans



Other Opportunities

- Managed care
- Utilization of services
- Disease Management Programs
- Prevention
- Prescription drug issues
- Medicare Advantage
- Medicare Integration





GASB 45 – Chautauqua County Case Study

- Education
- RFP Process
- Implementation
- Funding GASB 45
- Investment Strategy



Education

- *Educating your elected officials is critical!*
 - *Create a simple PowerPoint to present at committee level*
 - *Focus on defining what your OPEB's are*
 - *Relate to the "Real World"*
 - *Use auto industry as an example*
 - *Conduct multiple updates as you proceed through the process*



Education

- *Post employment benefits, other than pension benefits, are earned by all County employees but not paid for until retirement.*
 - *These Include: Health, Dental, Vision*



Theory Behind GASB 45

- *OPEB's are a part of the compensation for services rendered by employees. Benefits are earned and obligations accrue during employment.*
- *The current pay-as-you-go method does not recognize the expense when the liability is incurred.*



Define Benefit

- *County provides option/benefit to employees to convert sick day balances upon retirement to purchase health insurance from the County sponsored plan.*

**Health plan is a fully insured product.*

**Vision and dental are self-funded.*



Use Examples

○ OPEB Calculation

- *Every 5 accumulated sick days = 1 mo. of health insurance (employee responsible for paying 15% of premium)*
- *1 Month of coverage for every year of employment (minimum 15 years of service)*
- *Average retiree entitled to 3-4 years of health insurance coverage*



Education - Use Examples Cont.

- Employee Retires
 - 25 Years of Service
 - 100 Accumulated Sick Days

- OPEB Conversion
 - 25 Years = 25 Months
 - 100 Sick Days = 20 Months
 - Total Benefit = 45 Months of Coverage



Cost of Benefit

- Today's Cost
 - 45 Months X 2007 Family II Rate
 - $45 \times \$710 = \$31,950$
- Future Value
 - 8-12% Health Insurance Inflation
- GASB 45 accounts for benefits as they are earned, not just as they are paid



RFP Process

- Developed RFP for Actuarial Services and Posted 6/1/06
- Proposals Due 7/6/06
 - 6 firms responded
- Selected Actuary August 2006
- Commenced Work September 2006

Data Collection





Data Nightmare

- HR's demographic database did not coincide with payrolls
- Not all data required was in one database – merging required
- Unexpected data required – Implicit Rate Subsidy
 - Actual insurance claims paid for retirees segregated by those over 65 and those pre-65; further segregated by those receiving OPEB and those paying 100% share



Chautauqua County Liability - 2006

- 1,485 Insured Members
 - 1,183 Active Insured
 - 302 Retirees

- Unfunded Accrued Liability **\$25,282,000**
 - Annual Required Contribution \$3.1 million
 - Annual “pay as you go” cost \$800,000
 - Net OPEB Obligation \$2.3 million



Sensitivity Analysis

Medical Inflation Rate

Discount Rate	Less 1%	Baseline	Plus 1%
5.00%	23,204,400	25,282,000	27,631,600
6.50%	20,367,900	22,068,900	23,980,600
7.50%	18,770,800	20,269,400	21,946,800



Implementation

- Actuarial study utilized demographic data as of June 1st, 2006
- Recognized liability on 2006 Financial Statements
 - See PDF "2006 Chautauqua County Financial Statements GASB 45"



Management's Discussion & Analysis

- This year the County elected to early implement Governmental Accounting Standards Board (GASB) Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. This statement generally requires employers to account for and report the annual cost of other postemployment benefits (OPEB) and the outstanding obligations related to OPEB in essentially the same manner as pensions. Annual OPEB cost for most governments will be based on actuarially determined amounts that, if paid on an ongoing basis, would generally provide sufficient resources to pay benefits as they come due. GASB allows governments to apply this statement prospectively, establish the OPEB liability at zero at the beginning of the initial year of implementation, and does not require governments to fund the OPEB plans. Thus, the County established its OPEB liability at zero this year and removed the previously accrued retiree healthcare benefits for a total of \$5,926,340 from the governmental funds' compensated absences liability and \$799,983 from the enterprise funds' compensated absences liability. As a result, beginning net assets for the governmental funds increased by \$5,926,340 and beginning net assets for the enterprise funds increased by \$799,983.



Funding Options

- Funding for GASB 45 net liabilities is not required, **HOWEVER**;
 - If you “pay as we go” and do not fund on an annual basis, the net liability will continue to grow every year.



Funding History

- 1993 Chautauqua County established a designation of fund balance to account for post employment accruals
 - Sick days, vacation days, personal days
- Vast majority of the post employment accrual was the value of sick days



Funding History

- By implementing GASB 45, Chautauqua County segregated the vacation accrual from the sick time and dedicated that designation to fund GASB 45.
- 2006 Designation - \$9,750,000
- Additional funding through operating budget:
 - \$1,100,000 appropriated in 2007
 - \$660,000 appropriated in 2008
- Designation is accruing interest

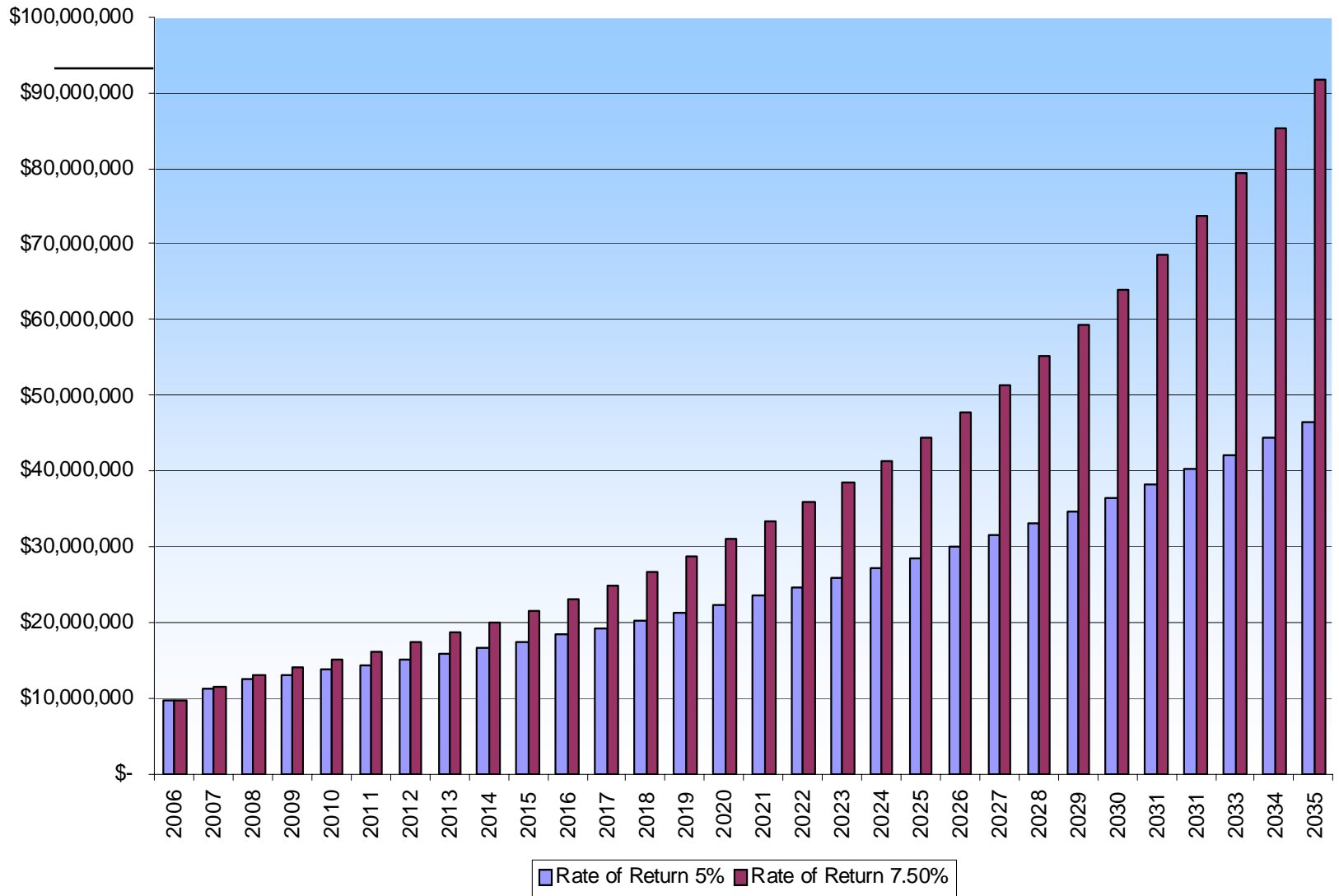


Investment Strategy

- Imperative for NYS Assembly & Senate to enact irrevocable trust legislation with unrestricted investment options
 - Provides for legal “funding” of liability
 - Allows for a market rate of return which will reduce liability upwards of 20%



Chautauqua County GASB 45 Funding Projection





Lessons Learned

- Develop timeline and multiply by 3
- Verify demographic data from multiple queries
- Notify insurance provider of data required concerning claims paid by required sub-groups
- Put auditors on notice
 - May not be technically prepared to recognize on financial statements

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Welcome and Introduction

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Albany Update

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Questions and Answers



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